









Canada. Royal commission on  
transportation


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ROYAL COMMISSION  
ON  
TRANSPORTATION

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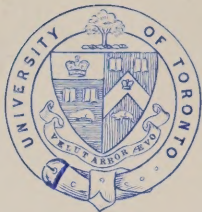
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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO,  
WEDNESDAY,  
MARCH 8, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D.	-	CHAIRMAN
HAROLD ADAMS INNIS	-	COMMISSIONER
HENRY FORBES ANGUS	-	COMMISSIONER

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G.R. Hunter  
Secretary

P.L. Belcourt  
Asst. Secretary

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COUNSEL APPEARING:-

F.M. Covert, K.C.	}	Royal Commission on Transportation
G.C. Desmarais, K.C.		
H.E. O'Donnell, K.C.	}	Canadian National Railways
H.C. Friel, K.C.		
F.C.S. Evans, K.C.	}	Canadian Pacific Railway
I.D. Sinclair		
C.D. Shepard	}	Province of Manitoba
Wilson McLean, K.C.		
M.A. MacPherson	)	Province of Saskatchewan
J.J. Frawley, K.C.	)	Province of Alberta
F.D. Smith, K.C.	}	Province of Nova Scotia; Transportation Commission of the Maritime Board of Trade
J. Paul Barry		
C.W. Brazier		
	)	Province of New Brunswick
	)	Province of British Columbia

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Ottawa, Ontario  
Wednesday, March 8, 1950.

M O R N I N G   S E S S I O N

---The Commission resumed at 10.30 a.m.

S. J. W. LIDDY - Recalled

EXAMINATION BY MR. COVERT - Resumed:-

Q. Mr. Liddy, I think nearly at the close yesterday, I asked you a question, and I think you said you would give the answer "yes", but you wanted to have a look at it. I thought perhaps you would like to discuss that first.

A. Yes, the Chairman was very kind to me and gave me permission to think over this question last night. I still think it is quite a question.

THE CHAIRMAN: Will you tell us what is the question?

A. I will read it:-

"Q. I would like to ask you this, Mr. Liddy: is it fair to point out that if the straight line method is used consistently in a rate application based on requirements, the Board of Transport Commissioners would not find your requirements as high as they would in the case of a user basis if at the time of your application your traffic volume were heavy and hence your depreciation requirements were high?"  
And then, sir, you go on and ask a question:-

"Your traffic requirements were what?"  
So I take it that the transcript should be amended to read in about the middle of that question:-

"...would not find your traffic requirements..."  
the traffic or revenue requirements.





THE CHAIRMAN: Revenue I suppose it would be?

A. Would be a more clear expression.

MR. COVERT: Q. Yes, that is right, I am sorry. I thought he was referring to the traffic volume.

A. I think this question does refer to the - -

Q. Yes, it does.

A. Well, the answer that I gave, namely "yes", is correct, but I would like to qualify it to one extent.

Q. Go ahead.

A. And that is, I think the question at the same time should give the converse of the situation, because Mr. Covert asked me: "Is it fair to point out...".

Q. That is right, and what you say is in the converse case where your traffic volume is small and if you were under the user basis, then your depreciation requirements would be lower?

A. Yes.

Q. So your revenue requirements would be smaller?

A. Would be higher.

THE CHAIRMAN: Q. What is that Mr. Liddy?

A. Would be higher the way I would state it.

Q. Would be higher?

A. Yes, sir. The way I would state it would be this.. "And conversely would find our traffic or revenue requirements higher than they would be in the case of a user basis if at the time of a rate application ...".

Q. Yes.

MR. COVERT: Q. Yes, that is, if you were on the straight line basis as compared with the user basis, yes, I follow.

A. That is what the question - -



THE CHAIRMAN: The straight line basis would be uniform of course throughout the period of years, and naturally the user basis would vary, sometimes would be higher than the straight line and sometimes lower according to the volume of your traffic. Isn't that right?

A. Exactly.

Q. So in some years your requirements would appear to be less and in others would appear to be more?

A. Yes, and the point of this question is that the revenue requirements on a straight line basis would be found to be less in a good year and more in a poor year, and that is the very point we have been stressing, and with our user rates that that is not a businesslike attitude to take.

Q. Well, as I said, the straight line requirements would be uniform, they would be the same regardless of the particular year, wouldn't they?

A. Quite right, sir.

Q. Whereas yours would vary with the yearsthe volume according to the years.

MR. COVERT: Q. So it might make a great deal of difference, Mr. Liddy, depending on the year in which you made your application for increased freight rates; it might make a great deal of difference if you were on the user basis as to the opposition you would meet. I suggest that might be one of the reasons that there is opposition to the user method, when you are in a period of high traffic volume.

A. Yes, that has been the situation as we have actually experienced it, and, as I think I pointed out, sir, in my examination-in-chief, I see no reason why depreciation should not be a flexible element just the same as - -





Q. As any other cost?

A. To take for example - -

THE CHAIRMAN: Excuse me, what did you say?

A. Should be a flexible element just the same as any other item that may be in our cost. Take for example the cost of coal. Supposing in a high traffic year freight rates average 1¢ a ton mile, and that the cost of coal is one mill. Now, because it is one mill and because there are many tons of coal used in that particular year when there is a lot of traffic moving, is no reason why it should not be proper in a period of low traffic volume to charge one mill. I know that the quantity of coal burnt in and used by railways in a low year will be less and in a high year will be more, but that goes up and down with the traffic. That is quite a logical thing, and that is all we want for our depreciation charges, to go up and down with the traffic just the same as coal charges do.

Q. Well, at the same time the rates you have to get are inflexible and they have to go on for a period of years, usually, don't they?

A. That is quite true, my lord, but that is a business situation in the world that you just have to face.

MR. COVERT: Q. Now, Mr. Liddy, you recall that in your examination by Mr. Shepard, there was some discussion of amortization of defence projects, and I think you used these as an indication that the Interstate Commerce Commission have permitted depreciation charges on other than the straight line basis.

A. The Interstate Commerce Commission and the Internal Revenue Department, I think, the Internal Revenue Department of the United States, allowed the railways to





supplement their ordinary straight line depreciation charges very extensively.

THE CHAIRMAN: Pardon me, supplement them with what?

A. With additional charges in their accounts.

MR. COVERT: Q. I was going to ask Mr. Liddy if it is not true that amortization of defence projects represented the writing off of expenditures incurred for war purposes and corresponded substantially to special war contracts depreciation allowances permitted by the War Contracts Depreciation Board in Canada during the war. Wouldn't it be very similar?

A. No, I think it is dissimilar. This is what was done.

Q. Wouldn't the same principle be involved?

A. Well, the same factual background is not involved. Let me explain what was done. The railway during the war found it necessary to purchase a hundred locomotives to handle more traffic. They said that they would not ordinarily purchase those locomotives if there had not been this surge of war traffic. They were allowed to amortize completely the cost of those 100 locomotives in five years. Now, they still have those locomotives; they simply are now taking the place of locomotives which would, in the ordinary course of events, have come due for retirement over the various years.

Q. Yes, then they have really given them what amounted to special depreciation of those locomotives?

A. That is right, called by a different name.

THE CHAIRMAN: They fixed the time as five years, did they?



A. Yes, sir, that was the minimum.

MR. COVERT: Q. Now, did not the Canadian Pacific for instance, get similar treatment in Canada?

A. We didn't - -

Q. I don't suggest you got 100 locomotives, but didn't you get special depreciation?

A. The Income Tax Department accepted our user method of depreciation.

Q. Did they regard that as special depreciation?

A. No, they just took it as the ordinary run of mine depreciation.

Q. Mr. Liddy, for instance, the Canadian Pacific did a large amount of war work?

A. Yes.

Q. And you would get special depreciation on your equipment in that connection, wouldn't you?

A. Well, not for company operations.

Q. That was outside?

A. That was outside. I can give you an example to clear that up.

Q. Like the Angus Shops building tanks?

A. We built the tanks for the Government and charged the Government, that was a charge against the Government. That was not on our railway accounts at all. Our railway accounts were limited exclusively to user depreciation.

Q. And your depreciation of a project like that would be kept entirely separate from your railway operation?

A. Absolutely. It might be a matter of interest, Mr. Covert, to know that the Canadian Pacific has paid over \$155 million of Income Tax since 1920 and these taxes are in our accounts in Exhibit 190.





Q. Was that just the railway operation now?

A. No, in the railway there was \$116 million and in Other Income there was \$42 million. You can see from those figures that we are not dealing with something that is a trifle. We are dealing with something that is most important to the Company which I represent, something which is most important to the employees and to the shippers as well as to the shareholders.

Q. Now, Mr. Liddy, I did want to ask one further question about this practice in the United States. Would not the amortization of defence projects in a good many cases include specific railway lines that had been built to war plants, rather than the locomotives to which you refer?

A. There were some additional spurs, I would take it, that were built, Mr. Covert, but the figures that I put in the record (I am sorry I haven't got the pages of the record) pertained only to equipment.

Q. Only to railway equipment?

A. That is right. The figures again, just to refresh your memory - -

Q. Would that be running equipment?

A. Oh, yes. Just to refresh your memory again - -

Q. I remember they were very extensive. I don't want to go into it any more. I think it is clear. It is all set out right in the record. I just wanted that question answered.

A. Yes, sir.

Q. I also want to ask you (and perhaps you have answered this) since you have adopted the user basis in Canada have you ever made a request in respect of your U.S. lines, either the ones directly owned or indirectly





owned?

A. No, for this reason, Mr. Covert, that we apply our user basis to our system figures including these small lines that enter the United States through Maine and through Vermont. We apply the user basis to our entire system, and then for the purpose of the Interstate Commerce Commission we simply make a side record of the depreciation that they ask to be applied on these particular lines. So that that does not affect our system figures, and whether they put it on the same basis or didn't, it didn't make any difference to our accounts.

THE CHAIRMAN: Insofar as the Interstate Commerce Commission is concerned, do your lines in the Eastern United States form part of one of these regional groups that they deal with?

A. Yes, the Eastern Region.

Q. Part of the Eastern Region?

A. Yes, sir.

MR. COVERT: Q. And I think you said that you did not know of any American roads that had made a request to use it yet?

A. No, the invitation is in Docket 15-100, but, you see, when depreciation on road property was put in in January 1943, the American railways were in the midst of war traffic, and there has not been much opportunity yet to get straightened out.

Q. I think you really disagree - or perhaps I should not put it that way. My understanding was, Mr. Liddy, that the Interstate Commerce Commission indicated that it was harder to police the user method than the straight line.

A. No, that was my interpretation. I was asked that



question once in a rate case.

Q. Yes.

A. And my answer to that question was that when the Interstate Commerce Commission was dealing with - I think it is over 500 railways that report to them, that they have a problem there of mass volume to deal with, and that situation of course does not pertain at all to Canada.

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(Page 17381 follows)





Q. The difficulty of policing the user method is really the number of railways in the United States as compared with the few in Canada?

A. That is the only problem that I see.

Q. Now, I think during your evidence there was a question raised, I think, by Dr. Innis, on the Canadian income tax regulations. I believe you stated it was usual for the tax department to fix maximum allowances. Could you tell us if it would ever be possible that depreciation charges, under your user system, ever reached these maximum allowances, or exceeded the allowances permitted by the tax department?

A. No, I don't think they have.

Q. I also wished to ask you, Mr. Liddy, if depreciation regulations are issued by the regulatory body -- the Board of Transport Commissioners -- would it not be desirable to make sure, if it was possible, that methods or rates approved by the regulatory body would be accepted by the income tax authorities for income tax purposes?

A. Oh, yes. I see no difficulty there, for this reason, Mr. Covert, that the income tax department, once you have claimed depreciation, it is then deducted from the balance; it is taken on the declining balance, and you will never get it again.

THE CHAIRMAN: Q. You never get what again?

A. You will never be able to recapture that depreciation again. The income tax department have an automatic safety device in that they say -- take the railways for example. You can charge six per cent depreciation if you want to, but when you charge six per cent that comes off your balance of the amount of property that is depreciable, and then it becomes six

...the United States as a ...  
with the law in ...

That is the ...

I think that your evidence that was

...the Canadian ...  
...the maximum allowed ...  
...it would be possible ...  
...even though it was ...  
...all was ...

the tax department

I don't think they have

I am ...  
...the regulatory body ...  
...it would not be ...  
...that would be ...  
...by the regulatory body would be ...

the tax authorities the income tax companies?

Oh yes, I see no difficulty there, for this

...the income tax department

...the income tax department, it is then ...  
...the declining balance

...will be ...

THE CHAIRMAN: You never got what you want?

...with never ...

...the tax department ...

...the way ...

...You can change ...

...but when you ...

...the balance of ...

...the declining balance

per cent on that balance, and six per cent on the new balance. Finally you get down, if your balances are less than one half of your depreciable property, six per cent on that only amounts to three per cent; and if you charge for too much depreciation then you get down to even less than three per cent. So that it is an automatic control device.

MR. COVERT: Q. You are discussing the new regulations in income tax?

A. Yes. Well, in the old regulations they kept track of your accrued depreciation.

Q. Yes, they kept track of it, but it was quite a different system to the present?

A. That is true.

Q. What I wanted to find out, Mr. Liddy, is whether or not there should be some liason between the income tax department and the Board of Transport Commisioners, so that, for instance, they could check. . . It might even reach a stage such as this, that the income tax department would accept the figures checked by the Board of Transport Commissioners. Is there a situation like that in the United States, a liason between what they call the department of Inland Revenue and I.C.C.?

A. My knowledge is not very specific in that respect, but I would think that the Internal Revenue Department would wish to keep its own hand on matters concerning taxation.

Q. I thought perhaps, Mr. Liddy, that if the figures are going to be <sup>so</sup> carefully checked by the regulatory body, that it seemed a duplication in government service.

A. It isn't that kind of a check that is involved so much as it is an interpretation of what is in the Tax Act.





THE CHAIRMAN: Might it not be rather the other way around, that the Board would take the figures established by the Income Tax Department?

MR. COVERT: Well, it might be, my lord, but it occurred to me that in the checking of depreciation on the user basis that the Board of Railway Commissioners should be better equipped to ascertain what is proper depreciation for a railway than perhaps the Income Tax Department. I don't know that.

THE WITNESS: Well, <sup>the</sup> Income Tax Department have its own rules and regulations; they are subject to change each time parliament meets. I really don't think you could tie them up too closely, Mr. Covert.

MR. COVERT: Q. Now, you don't have any difficulty with the tax department. You say they have accepted your user basis?

A. Yes. You understand that they have a ceiling.

THE CHAIRMAN: Q. You say they have a ceiling?

A. Yes. Mr. Covert asked me the question if the Income Tax Department accepted our user basis, and I am simply pointing out that the Income Tax Department have a ceiling, a six per cent ceiling.

MR. COVERT: Q. So that as long as your <sup>basis</sup> user/comes below the ceiling, that is the acceptance.

A. That is right.

COMMISSIONER ANGUS: <sup>Q.</sup>/ They accept any basis that comes below the ceiling?

A. Yes.

MR. COVERT: Q. The railway does fall under the new regulations?

A. The Canadian Pacific does?

Q. Yes.

A. Yes, sir.



Q. Now, I think Mr. Liddy you stated that expenditures on track structures, such as rail, ties, vary directly with use, and that renewal accounting provides the truest annual charge for such expenditures?

A. They vary almost directly with use, yes sir.

Q. If that is so, I was wondering what arguments were advanced with respect to changing to depreciation accounting for track structures?

A. Well, I think the railways in the United States have had some trouble with the Internal Revenue Department over a part of their assets being on renewal accounting, which is unusual in industrial practice.

Q. So that is it because of the move in the United States, Mr. Liddy, that you think that everything should go on depreciation accounting.

A. Well now, again I am not specifically informed.

Q. I see.

A. But that is as I interpret the move.

Q. Mr. Liddy, I suppose it would be fair to say that in recent years the fact that the replacement value of assets is now so much higher than the original cost . . .

A. Yes.

Q. That generally speaking the reserve for depreciation is probably insufficient to replace the article at the end of its life?

A. Yes, that has been quite a serious problem with all corporations, what to do about that situation. Take our present inventory of equipment: some of this equipment was purchased forty years ago, some thirty-five years ago, some twenty years ago, and so on. Today to replace our equipment at today's prices would require an addition to our property investment of





\$413 million. May I read to you an extract from the annual meeting of shareholders of the Canadian Pacific Railway held May 5, 1948, which deals with this particular subject. I quote:

"At current prices <sup>it is</sup> / calculated that the replacement of the company's rolling stock <sup>would cost</sup> inventory / approximately \$800,000,000. This is \$413, 000,000 more than the actual cost of rolling stock now in service. Likewise the replacement at current prices of the company's bridges, buildings and other depreciable property now carried on the books at some \$320,000,000, would require an outlay vastly in excess of that amount. Thus, even should existing prices decline somewhat in the future the need for surplus earnings merely to meet renewals will remain substantial for some years."

Q. What I wanted to ask you about that, Mr. Liddy, was this: is that one of the reasons why the <sup>funds</sup> company/it essential to have this . . . what is sometimes called surpluses and sometimes called something to come and go on?

A. That is one of the reasons. There are many reasons for surpluses. One big reason, and it is illustrated by the years during the depression - if we haven't got a little flesh on our bones you are just down and out.

Q. On that point, Mr. Liddy, if that surplus is to be raised out of freight rate, then should that surplus be used entirely for railway matters?

A. If that surplus is raised entirely out of freight rates?

Q. Yes.



A. Yes.

Q. And should any income from that surplus be used for railway purposes?

A. Yes, it always has been, and more.

Q. You mean this is what Mr. MacPherson called the leaning argument. That is what you are referring to?

A. That is right. We have been leaning on Other Income.

Q. I wanted to make sure of two things. One, the surplus should be used entirely for rail purposes, that is any surplus raised by increase in freight rates?

A. Yes.

Q. And that any income from that surplus should likewise be for rail purposes?

A. Yes. Now, the way we do that is this, and it is very simple. We have a surplus; we immediately go out and buy some property, a railway car, a locomotive, or bridge or building; we have returned to the railway, and it is earning income, and it is being credited to the railway, because all we are asking is a fair return on the net, after having done all that.

Q. You would say that certainly that situation should pertain in the future?

A. There is no doubt but it will.

Q. Would you say that it is fair to say that at the present all the surplus accruing from freight rates has been invested in rail enterprises?

A. Yes.

Q. You would say that?

A. We prepared for the Board of Transport Commissioners a segregated balance sheet, an income account, and the result of that segregated balance sheet





and income account was to show that over the years, right from the beginning of the Canadian Pacific operation there has been practically no surplus; notwithstanding the fact that in many years the company did pay dividends to the shareholders out of Other Income, rather than out of rail. That Exhibit 49-49 is now referred to as Exhibit . . .

Q. 196?

A. 196 in this case.

Q. We were diverted a bit, Mr. Liddy. I was discussing this question of the problem of the increased cost making it difficult for your depreciation reserve to properly provide for retirements at the end of useful life; and I wondered if you knew whether, -- and presumably the same situation exists in the United States on their railways--they had discussed that matter with the Interstate Commerce Commission in connection with perhaps allowing different kinds of depreciation?

A. I wouldn't be informed on that. But I do know the Interstate Commerce Commission have been sympathetic to the situation that the railways find themselves in, and have granted them very quickly, sometimes in the matter of a few days, freight increases.

Q. I think it is perhaps something a little different than that I was discussing, Mr. Liddy. I just wanted to know whether or not there had been any suggestion that depreciation should be on a basis other than historical cost.

A. I doubt very much if accountants generally are willing to depart from the orthodox method at this time.



Q. Mr. Liddy, would it be fair to say that perhaps one of the compelling reasons for changing your depreciation method when you did would be the change in the income tax rates?

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A. We have never changed our depreciation method, sir.

THE CHAIRMAN: Q. Speak louder, please.

A. Mr. Covert asked me would it be fair to say---

MR COVERT: Q. I mean you changed to the user basis, which would give you a higher depreciation in years of high volume; wouldn't that affect your income tax?

A. But my point is, we never changed; we never changed. We have always had the user basis. We started out with the user basis first on January 1, 1940, for equipment, and first on July 1, 1942, for road property, and we started out on the user basis.

THE CHAIRMAN: Q. Well, you are talking of starting out; then you refer to 1940; when did you start out on the user basis?

A. That is when we started depreciation. My point is, we started---

Q. What year have you in mind when you say you started out on the user basis? When did you start out on the user basis?

A. January 1, 1940, sir.

Q. What did you do before that?

A. We had retirement accounting; we did not have depreciation at all; so that we commenced depreciation---

Q. Yes, you told us that.

A. ---on the user basis.

MR COVERT: Q. May I put it this way, then, Mr. Liddy, that that was the year when the high income tax rates came into effect? I just wanted to find out if that was one of the reasons that you would go on the user basis?

A. That was not what was in our mind, Mr. Covert. I would like to give you a little past history of why we went to the user basis and when.

THE CHAIRMAN: Q. Are you going to talk about income

A. We have never changed our degree of interest.

THE CHAIRMAN: O. Speak louder, please.

A. Mr. Goveat asked me would it be fair to say---

THE CHAIRMAN: O. I mean you changed to the user base

which would be the higher percentage in terms of high

volume; wouldn't that be the case?

A. Yes, that is the case. However, we have not been able to

at that time, we have not been able to do that.

THE CHAIRMAN: O. I am not sure that is the case.

A. Yes, I am not sure that is the case.

THE CHAIRMAN: O. I am not sure that is the case.

A. Yes, I am not sure that is the case.

THE CHAIRMAN: O. I am not sure that is the case.

A. Yes, I am not sure that is the case.

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THE CHAIRMAN: O. I am not sure that is the case.

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THE CHAIRMAN: O. I am not sure that is the case.

A. Yes, I am not sure that is the case.

THE CHAIRMAN: O. I am not sure that is the case.

tax accounts, or simply freight rate statements?

A. May I for the purpose of the record, Mr. Covert, in answer to your question, quote an excerpt that appeared in the Report of Proceedings of the Canadian Pacific, May 4, 1938? The quotation is -- this is two years prior to the 1940 you speak of:

"Your officers have been carefully considering the adoption of depreciation accounting for rolling stock, and, on account of the wide fluctuations in traffic volume which occur in this country, have come to the conclusion that, if adopted, it would be desirable and proper that the depreciation charges should be spread over the life of the rolling stock on the basis of the use made of it year by year."

Now, sir, that was in 1938, that was a mid-depression year, and, as these proceedings clearly point out, it was because of the wide fluctuations in traffic volume, just as I gave in my evidence in chief, Mr. Covert. We want to be able to make an income account that is realistic, that means something, that has not got in there a frozen amount that upsets the true operations for the year.

MR COVERT: Q.

Then I just want to find out, Mr. Liddy, the main purpose is to get your depreciation on a fluctuating basis, the same as other costs?

A. That is right. Whether it is a user basis we don't care, Mr. Covert -- whatever means can be adopted. But now the accounting definition that is accepted by all accountants is that you must be systematic and rational; you must not jump around with just an arbitrary amount this year and an arbitrary amount the next year; you must have a rational basis.

Q. Now, Mr. Liddy, no doubt you pay considerable attention to the financial reports of the Canadian National?

A. Well, I don't know that I would say considerable





attention. I like their report; I read it. They get out an excellent report.

Q. I just wanted to call to your attention a sentence in the 1941 Report of the Canadian National, in which they say:

"In view of the more intensive utilization of system equipment, it was thought advisable to increase the provision for depreciation."

And I think they added a little over \$2 million that year for depreciation; they increased it, I think, from \$11.2 million to \$13.5 million.

THE CHAIRMAN: Have you told us what year that is?

MR COVERT: 1941, yes, Mr. Chairman.

Q. Then in the following year, 1942, they went on depreciation accounting, and, if I read their statement correctly, it shows the depreciation on equipment of about \$16.9 million compared with \$13.5 the previous year, and then in 1943 their depreciation on equipment was \$19.8 million as compared with \$16.9 million the previous year, and in 1944 I think it was \$19.8 million. Now, I was simply pointing this out to you by way of suggesting that perhaps you were not the only railway which had decided that there was greater depreciation called for with greater use?

A. No. Well, I am glad to know those figures, Mr. Covert. Nor are we the only corporation.

THE CHAIRMAN: Q. Nor what?

A. Nor are we the only corporation that thinks depreciation should be more realistic and go up and down with production. May I refer you in that connection of the Canadian National figures to a more detailed exhibit that was put in in the rates case?

THE CHAIRMAN: Q. By the Canadian Pacific?

A. By the Canadian National. Exhibit 223 filed in the



30% Freight Rates Case covered the years 1940 to 1946, and I may read this just for the purpose of the record.

MR COVERT: Q. Go ahead.

A. Really this information should be put in by the Canadian National. I hope they will excuse me for stealing their thunder.

In the year 1940 straight line depreciation charges were \$10,322,000-odd; additional charges in that year were nil.

In 1941 the straight line depreciation charges were \$10.6 million; additional charges were \$2 million.

In 1942 the straight line depreciation charges were \$10.7 million, and additional charges were \$5 million.

In 1943 the straight line depreciation charges were \$11 million, and the additional charges were \$7.5 million.

In the year 1944 straight line depreciation charges were \$11.5 million, and additional charges were \$7 million.

Then in 1945 they apparently adopted some higher basis of depreciation, because in 1945 the straight line depreciation charges were \$15.5 million, and in 1946 \$16.3 million. In those two years there were no additional charges.

I might say for the purpose of the record that practically all the exhibits put in in the freight rates case pertained to lines in Canada, not the Canadian National system figure.

Q. Now, I wonder, would it be possible to give us the depreciation claimed by the C.P.R. in those same years?

MR EVANS: They are in the Board's judgment.

MR COVERT: Rather than give them, perhaps we could have the page in the judgment; Mr. Evans is finding it; I think it might be noted at this point in the record.



THE CHAIRMAN: What was that last question, Mr. Covert?

MR COVERT: It was not a question, Mr. Chairman. I was just saying we could put in the record at this point the reference to the page in the judgment in which the figures appear.

THE CHAIRMAN: That is the 21% judgment?

MR COVERT: So I understand, Mr. Chairman.

MR EVANS: I think there is something; if there is not, I will give you a reference to an exhibit where it can be found.

COMMISSIONED INNIS: Q. Your initiation of the depreciation practice was not in any way affected by your financial position. I notice that you say 1938, the year in which you first discussed it, was a year in which you passed dividends on both your preference and your common stock. Was the difficulty of getting capital a consideration in the initiation of depreciation?

A. Well, I think the whole financial situation was in our minds, sir. We wanted to be realistic. Here was a year, 1938, when the traffic volume was low, and if we had adopted say depreciation charges in that year on a basis that would be the same in a high volume traffic year, that would make it very difficult for the company to go out in the financial markets with such a poor record as that, and that is the difficulty that is found by business firms generally.

MR COVERT: I understand, Mr. Chairman, that the comparative rates for the Canadian Pacific are not in the judgment. Mr. Evans says that he will---

MR EVANS: Exhibit 162 in the 20% Case.

MR COVERT: Perhaps I will just give them to Mr. Liddy, and we will have them in the record at the same





place, comparing them with the Canadian National.

Q. Could you give them to us, Mr. Liddy?

A. You wish the amount of depreciation?

Q. Yes.

A. Taken in each year?

Q. Yes.

A. In the year 1940 our depreciation for rolling stock was \$10,317,000; in 1941 \$12,700,000; in 1942 \$12,777,000; in 1943 \$13,953,000; in 1944 \$15,224,000; in 1945 \$15,522,000; in 1946 \$14,402,000.

Q. There would be this distinction for purposes of comparison of the two, Mr. Liddy, that the C.N. would have no depreciation on roadway property at all?

A. The figures I have just given you are for rolling stock, just the same as the Canadian National were for rolling stock.

Q. I see. Now, I want to have this on the record at this stage too: It would not be possible, Mr. Liddy, to have any comparable figures for the years before, because you just were not on that basis?

A. That is right. Both the Canadian National and the Canadian Pacific started depreciating rolling stock January 1, 1940.

Q. Incidentally, Mr. Liddy, did the two railways get together and discuss that matter and come to the conclusion that they both should?

A. I would think so. We do co-operate a great deal more than perhaps the outsider thinks.

Q. Mr. Liddy, you have no doubt examined the section of the Interstate Commerce Act dealing with depreciation; it is in section 20, subsection 4.

A. Well, I kind of shy away from Acts---

Q. I am not asking for legal interpretations at all,



Mr. Liddy.

THE CHAIRMAN: Are you referring to the Railway Act?

MR COVERT: To the Interstate Commerce Act, Mr. Chairman. Subsection 4 reads:

"The Commission shall, as soon as practicable, prescribe for carriers the classes of property for which depreciation charges may properly be included under operating expenses, . . ."

THE WITNESS: What date is that, Mr. Covert, may I ask?

MR COVERT: I think that that is the section that is still in force.

THE WITNESS: Yes. I was wondering----

THE CHAIRMAN: Do you know when that began?

MR EVANS: The marginal note may have a clue, Mr. Covert. I do not know what those marginal notes mean, I am sorry to say.

MR COVERT: Yes, I think, Mr. Chairman, I can tell you. It will be 1920. In the marginal note in the copy which I have it has "41 Statute L 493", and I notice in the front of the book there is a contents section which shows that that was in 1920.

Q. Then it goes on, Mr. Liddy:

"and the rate or rates of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose."

What I wanted to find out was if, as an accountant, that is the same kind of thing that you would require here -- that is, that the Commission should prescribe the classes of property for which depreciation charges may properly be included?

(Page 17397 follows)





A. Well, may I say this, Mr. Covert, that in 1920 the railways of the United States were already depreciating rolling stock, so that I take it this is a specific reference - -

THE CHAIRMAN: Pardon me, did you say rolling stock or road stock?

A. Rolling stock. They were depreciating rolling stock mandatory since 1914, so that this portion of the Act then pertains to road property. Now, I always hesitate to interpret this statute.

MR. COVERT: Q. No, I just wanted to know from you as an accountant, and you are working, we will say, under uniform accounting regulations, and uniform depreciation regulations, whether or not it would be essential for the regulatory Board to prescribe for carriers the classes of property for which depreciation charges may properly be included.

A. I agree with that step.

Q. Yes, and the rate or rates of depreciation which shall be charged with respect to each of such classes of property.

A. Yes, and which shall classify the carriers for this purpose.

Q. Yes.

A. Now, take as a practical thing in Canada, without being slighting in any respect to small railways, there are only two railways, the Canadian National and the Canadian Pacific. That would mean classifying the Canadian National and Canadian Pacific as to what kind of depreciation rates we would have for road property.

Q. Right.



A. Well, I guess there can be no real difference of opinion between us in that respect, but I submit that the sensible thing to do is to take the experience of the carriers, the experience of their engineers - -

THE CHAIRMAN: That is what you say the Board ought to do if it was directed by our statute to do the very thing that is directed in the United States statute?

A. Yes.

Q. You are going on to say now what you think the Board ought to do?

A. Yes.

Q. But the point is, as a beginning, do you think that our statute should say that the Board shall do these things?

A. I don't think in Canada - -

Q. You don't think it is called for?

A. That is right.

Q. Because we have only the two railways?

A. That is right.

MR. COVERT: Q. I just want to make sure that I got that. You say it is not necessary to have a section like this in Canada because you just have two railways?

A. Well, I think we ought to agree on what are depreciable assets, because I don't think we can get any starting point unless we start with that.

Q. Then, let me put it to you this way. What you say is that there probably should be legislation to enable the Commission to prescribe for carriers the classes of property for which depreciation charges may be properly included.

THE CHAIRMAN: Would you excuse me, you mean the "Board". You said "Commission". Just for the purpose of



the record.

MR. COVERT: Q. I am sorry, the Board of Transport Commissioners should prescribe the property.

A. That would appeal to me as an accountant.

THE CHAIRMAN: Have they not those powers now without any amendment to them?

MR. COVERT: I don't think they have.

THE CHAIRMAN: You don't think they have? Then we will have to pursue the inquiry.

COMMISSIONER INNIS: Don't you think it might be more important to have that type of regulation in Canada just because there are two railways? You have two extremely powerful groups who must be more subjected to regulation than would be the case with the large number of railways in the United States.

A. Well, I certainly agree that the Board should approve our rates. Otherwise how are we ever going to have a rate case without interminable delay in these matters? But for the Board in Canada, a small organization, say, how is it going to say what the rate should be? Now, in the United States they have a very elaborate Interstate Commerce Commission with all kinds of branches and they have a Bureau of Valuation there that is very very expensive, and they are equipped to do these things.

MR. COVERT: Q. Could we just stick to this one thing at a time? First of all, you agree that the Board should have power to prescribe the property which is to be subject to depreciation. Do you agree with that?

A. I have no objections to that.

Q. As an accountant you think you really need that?

A. I think that is a starting point.





Q. Yes, and you also think that they should fix the rate or rates of depreciation on that property? Do you think they should do that?

A. Well, I am in difficulty as to what you mean by "fix", the interpretation of that.

Q. Well, should they determine? Is it <sup>perhaps</sup> that you don't want to answer that because you are afraid of the question of user and straight line method, is that what you mean?

A. Well, besides it would require a very elaborate staff of the Board to function under that.

Q. Then what you mean is, are you saying now, Mr. Liddy, that the railways should fix that with the approval of the Board?

A. They should go up to the Board and submit their data and get the Board to approve it.

THE CHAIRMAN: Yes, but the Board, as you say, for the very reasons you have given, have not got a staff which could give them independent advice about whether they should approve or not.

A. No, but we can give them an analysis. They can come to us and look at our books and do anything they want to.

Q. If they had the proper machinery?

A. It is a lot different than saying to the railways: "Come to us and we will tell you that it is 3%" and no argument about it.

Q. Yes, in your case you would act first and then they would review it as best they can and approve of it or not.

A. That is right. Now, the railways do that with equipment in the United States. They submit to the Interstate Commerce Commission an analysis of what they think



their depreciation rates should be, and the Board looks over their data and O.K.'s it or rejects it.

Q. Having regard to the fact that this Board has this equipment that you refer to, they can do that very easily?

A. Yes, they can do it very easily, but this particular section, I think, must refer more to road property.

Q. Oh, yes. Road property, you mean stations and bridges?

A. Stations and bridges, for which the Interstate Commerce Commission have set up a very elaborate Bureau of Valuation with a lot of engineers all over the country, and have gathered a lot of data.

MR. COVERT: Q. Well, Mr. Liddy, Mr. Evans suggested to me that perhaps you were not quite following me, in that you were drawing a distinction, I think Mr. Evans put it, as between the checking of rates from year to year.

MR. EVANS: Yes, the process; were you trying to distinguish the process by which the Board's staff would be fixing rates every year and doing a continual check of those, as compared with approving rates that you would submit in rate cases? I was wondering if that was what you had in mind.

THE WITNESS: No, I mean the continual approval of our rates on a systematic basis.

THE CHAIRMAN: Q. Are you talking of from year to year, a continual review?

A. Oh, yes.

Q. Now, that is what goes on in the United States, is it?

A. Yes.





Q. Under those sections you have just read?

A. Yes.

Q. But you say our Board here is not sufficiently equipped to do such a thing?

A. Yes, but my point, sir - -

Q. You do it and go to them and ask them to approve it, that is what you meant?

A. Yes, I think that is the sensible thing to do in Canada rather than set up - -

Q. You see, as it is now, you only go to them when you want a change in the freight rates.

A. That is right.

Q. And that might be once in a great while?

A. That is right.

Q. But have you in mind something different whereby you keep on going to them year by year?

A. Yes, sir.

Q. So that you would be in touch with each other continuously?

A. Yes, sir.

THE CHAIRMAN: What about that, Mr. Covert?

MR. COVERT: It seemed to me, Mr. Chairman, that in the final analysis the Board had the power to approve or disapprove the rates, but in effect they had the power to fix them, and that all Mr. Liddy is talking about is whether the railways are in a position to convince the Board that the rates which they suggest are the proper ones.

I don't know whether we are talking in circles for that reason, because it just seemed to me that if they had the power to approve that does include the power to fix. Mr. Liddy, it seemed to me, is talking about a situation where he



says they have not the staff or the knowledge to enable them to do this, and "We should be able to go before them and show them and then they approve". Well, that seems to me to be really the same thing. All he is really saying is that here the railway know and they can tell the Board and the Board can approve; but that meant in the final analysis that the Board must fix the rates now. If his difference with me is that the only time that they fix the rates is when there is an application for an increase, then that is something different.

THE WITNESS: I did not mean that.

MR. COVERT: Q. What you do really mean, Mr. Liddy, is that the Board should have the power either to approve or fix rates, and that the railways should be able to come in and show their case?

A. I believe that would be a sensible thing to do.

Q. And you would agree, I think, Mr. Liddy, that the Commission should have the power to modify both the classes and the rates that are prescribed. For instance, there might be changes that would necessitate modifications of both the rate and the classes?

A. Well, if you give them power to approve and they refuse to approve, I presume it amounts to the same thing; but there again I am in the hands of counsel as to what a statute like that may mean.

COMMISSIONER ANGUS: But do you mean that if you give them the power to fix the rate, in the practice of the American Commission, it may put ideas in the heads of the Canadian Board and they may demand an expensive staff?

A. You may be right, Dr. Angus. To me in Canada here we are a small country with two large roads,. Both roads



want to do what is right. Let us not jump into a grandiose scheme. I suppose you would call that just a little horse sense, I don't know, but I am in the hands of counsel as to how the Act should read.

COMMISSIONER INNIS: What I am concerned about is, of course, that in a small country with two such powerful railways, one cannot always be certain that their interests are the same as the country concerned; and that you must have a sort of regulation, or perhaps even more effective regulations, than would be true in the United States.

A. Well, that is beyond my sphere, I am afraid, Dr. Innis.

MR. EVANS: Perhaps the best answer to you, Dr. Innis, is that the Board has not been impressed by that so far in the rate cases.

COMMISSIONER INNIS: I am wondering whether that is because of the character of the Board.

MR. EVANS: What I am saying is, that they have not been overborne by the railways over it, because they have cut millions of dollars out of our depreciation in recent rate cases.

MR. FRAWLEY: As I understand it, that is just an automatic consequence of disapproving the user and adopting the straight line.

MR. COVERT: Q. Now, I want to go on Mr. Liddy, to the subject of uniform accounts. It is my understanding that the classifications of investment in rail property shown in Exhibit 181, I think you said they were in accordance with the I.C.C. classifications?

A. Yes, Mr. Covert.

Q. Can you tell me approximately when the Canadian





Pacific adopted these classifications?

A. Only within these last seven or eight years.

Q. Well then did you have any difficulty in allocating investments in rail property, investments made after that time?

A. Yes, it required a lot of work, required a great deal of work, Mr. Covert. The classification that the Canadian Pacific had up to that time was a descriptive classification, such as: new stations, new terminals, bridges and so on. Wait until I read you the general classifications that we have here.

Q. You are taking prior to the adoption of the I.C.C. classification, are you?

A. That is right. This is not complete; it is only indicative of the kind of classification that we had in our investment accounts:-

"Additions and betterments to stations, freight sheds, coaling and watering facilities and enginehouses; replacement and enlargement of structures in permanent form; tie plates, rail anchors and miscellaneous roadway betterments; replacement of rail and main line and branch line tracks with heavier sections; additional terminal and sidetrack accomodation; additions and betterments to shop machinery; new rolling stock; additions and betterments to rolling stock".

and so on, and it goes to other activities. Now, that is perhaps what you might describe as a project classification, whereas the Interstate Commerce classification, as on Exhibit 181, is more of an engineering classification. Listen to



these items:-

"Grading, tunnels and subways, bridges, ties, rails, fences, station buildings, roadway buildings, water stations, wharves and docks" and so on. That is more of an engineering classification, whereas our Annual Report, as I have said, is more a descriptive classification, and was designed really for the information of shareholders, the man on the street.

Q. Yes, now then, Mr. Liddy, you adopted this new classification, you say it would be around 1942?

A. It may have been started in 1941. I am not sure of the date, Mr. Covert.

Q. And there must have been a great deal of difficulty in fitting that classification into the past?

A. Yes, it required a fairly large staff working continuously.

Q. Yes, I suppose there would be a requirement of the exercise of considerable judgment.

A. In segregating these by primary accounts?

Q. Yes.

A. Well, there was a lot of factual data available .

Q. Would not some of it have to be on a pretty arbitrary basis?

A. Well, there may have been a few items, but we had engineering records and accounting records fortunately going right back to the beginning of time for the Canadian Pacific. We had to dig out those original vouchers, original contracts, engineering plans; and if we were in doubt about any item, then we always had available to us the local engineer to consult in regard to any facility.

Q. Now, Mr. Liddy, I think you stressed that any





classification adopted should be designed for conditions in Canada?

A. I think that is a sensible thing to do.

Q. Now, in general terms how would you suggest that this would affect the classification which the C.P.R. has been following in view of the statement that it has substantially adopted the I.C.C. classification?

A. We will take this Exhibit 181. Now, the main purpose of this classification is to get your depreciable and non-depreciable property by engineering classifications of assets. Take the first item, "Engineering". Now, let me look down at the first item under "General Expenditures", "Organization Expenses, General Officers and Clerks". Well, why separate engineering expenses from the general officers and clerks and organization expenses? What purpose is there served in getting a lot of data?

THE CHAIRMAN: Well, why did you do it then, who compelled you to do it?

A. We followed the Interstate Commerce Commission classification which we say we follow. Now, if there is to be an accounting classification in Canada, my thesis is: don't go beyond what is really necessary and reasonable.

MR. COVERT: Q. Now then, Mr. Liddy, can you tell us what other changes you would make? That would be one, engineering.

A. Well, I have not really analysed this situation. There are other items in here that are spread on what we call an overhead. Take revenues and operating expenses during construction. I don't know why you need that at all. I would have one pretty much common pot for all these things that are of that kind, spread over the depreciable and



non-depreciable items as an overhead.

THE CHAIRMAN: How does that item come out as a credit, revenue and operating expenses during construction?

A. Well, suppose we had constructed the line, and during the period of construction we did carry some freight for revenue.

Q. Oh, yes.

A. But the line is not yet turned over to the operating part.

Q. But you operate just pending the turning over?

A. Yes, sir, but I have not attempted to say how simple this classification in Canada should be.

MR. COVERT: Q. No.

A. I think that is a matter upon which all minds should be brought to bear. The Canadian National have their views.

Q. May I ask you this, Mr. Liddy. There are some departures from the I.C.C. classification now?

A. In this?

Q. Yes.

A. Which one are you thinking of?

Q. I am putting it in the form of a question. I am asking you, are there some departures now?

A. No, the only equipment we have not yet distributed is rented sidings. There is one item there, rented sidings. That is largely rail and other track material we have not just segregated yet, but outside of that I think it is entirely the I.C.C. classification.

Q. Then you are suggesting that to design it properly to meet the conditions in Canada, there should be some further departures?

A. My thesis is: let us consolidate. My thesis always



has been: let us consolidate, let us put three or four amounts together that don't mean anything in themselves; because every time you have a separate account you have to have distributions of payrolls, distributions of vouchers; you have to have clerks making separate accounts, you have to have men out on the line giving you that information. The simpler and the fewer the number of primary accounts you can have, the less costly the accounting system will be.

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Now there is always on the Canadian Pacific a desire by our operating people for the accounting department not to ask them for too much detail, because they say their job is to operate; they don't want to have clerks made out of their operating men. There is a great deal of resistance in getting some of the information we now get. In Canada my thesis, for what it is worth, is that we will maintain all major comparisons in primary accounts with the United States railways, and let us see to what extent the others/<sup>that</sup> don't mean anything can be simplified.

THE CHAIRMAN: We will take a few minutes off.

----Recess.

--- On resuming:

MR. COVERT: Now, Mr. Liddy, you have urged the desirability of uniformity, and I think you have suggested that in the case of depreciation where uniformity could be achieved it might be well to permit railways to follow different policies. Now, I want to ask you if this opinion is based on the belief that regulations could be laid down in respect of depreciation, renewals and retirements which would permit the removal or the elimination of such items from the accounts of railways, and still give comparable figures exclusive of these items?

A. I did not quite catch your renewal and retirement feature. Would you repeat that particular section?

Q. Yes. I asked you if this opinion was based on the belief that regulations could be laid down in respect of depreciation, renewals, and retirements which would permit the removal or elimination of such



items from the accounts of railways, and still give comparable figures, exclusive of these items?

A. I may not have got all that question, but see if I am answering your question directly.

Q. Yes.

A. If we put --

THE CHAIRMAN: Q. If you what?

A. If the Board places all depreciable assets -- all assets that are depreciable -- before the railways, and say now you have to depreciate those assets in some manner . . . you must not have renewals or retirements or some other plan on those assets; you must at least go to depreciation. That would then mean that the railway company would be able to show the Board, and the Board would have the data whereby they know the investment in all such depreciable assets, that is the dollars. One company may say "I want to charge out five per cent of those particular assets each year", and you look through your operating account and you see that the operating account bears five per cent of that particular investment. It is right in the operating expense account. Another railway would say that it wanted to put that on a flexible basis. That railway company shows to the Board how much dollars it has in investment, and it shows in its operating account what the accruals were for depreciation.

Thus, you have a perfect comparison. You have the comparison, in the first place, of dollars of investment, and you have the comparison of what the current charge for operating expenses may be for accruals. You can weigh those; you can adjust them; you can make them uniform in any freight rate case that you want to,





provided that you initially have the dollars to start with for investment. Now that is one aspect. I hope I am still on your question.

MR. COVERT: Q. Yes, that is right.

A. There is another aspect: no matter what basis of depreciation one may choose, provided that it is <sup>a</sup>/rational basis, that you will find that over the life of an asset under orthodox accounting you must come out to the same amount. If you have a hundred thousand dollar project to depreciate and it is a thirty-year-life, no matter what the basis of depreciation you have, you must come out that you have depreciated all that asset and the charges are equalized. So therefore taking any period of time in railway history, no matter what the method of depreciation is, you will have uniformity. You will not have uniformity if one method postpones the cost of retirements until the date it may be retired; it may be fifty years, maybe sixty years, or maybe seventy years. Under such a basis there can be no comparability in accounting, and there can be no comparison between such accounting and depreciation accounting.

Q. You in effect say then, Mr. Liddy, that you can have a departure from uniformity and still have comparability?

A. Yes.

Q. Even though, for example, one railway is on straight line and the other is on the user basis?

A. Yes; you may have to make some adjustments or you may have to take a longer period, but you have still got comparability. I think in my examination-in-chief, Mr. Covert, I did point out that the Interstate



Commerce Commission felt that they had comparability although they had some optional provisions in their classification.

Q. Yes, I recall that.

A. If you take a long enough period in accounting you must charge completely for every asset that is worn out, in some way or other.

Q. Now, Mr. Liddy, you recall Mr. Brazier asking you some questions regarding the treatment of accounts in the Canadian Pacific in the case<sup>of</sup> the Toronto Terminals Railway, the revenues, expenses and investments. Now, without questioning the statements which the company use for reporting to shareholders, do you think it would be useful, or at least informative, for a regulatory body to obtain a consolidated statement showing the company's total investment in properties, and its rail operations, whether conducted by the company or by a partially or wholly owned enterprise?

A. No, I can see no advantage in that. The regulatory body, such as the Board of Transport Commissioners, has reports from all railways in Canada, including the Toronto Terminals.

Q. Now, what I want to suggest to you is, if such consolidated statements are not prepared, is it not possible that railway operations could be over-charged, or under-charged, with the opposite result in the case of Other Income?

A. Well, I think the onus of proof is on the other fellow to say so.

Q. Well, that is not quite an answer to my question. I say it is possible, and if you had the consolidated statements, there would be a possibility of



perhaps checking?

A. Well, first of all you have got two railways in this Toronto Terminals, the Canadian National and the Canadian Pacific; now, that was a joint agreement.

Q. That was what?

A. That was a joint agreement. Then your question really comes down to, is it possible that two railways would do it?

Q. Perhaps I picked a bad example.

A. No. I am just following the Toronto Terminals . .

Q. I follow you exactly. In other words, they would both have to do the same thing.

A. Both have to be bad boys, yes. Well now, there is absolutely no need for us doing anything like that, and there is no intention of us doing anything like that, and no one has been able to point out in any respect that we did it.

Q. No, I am not suggesting you have done it, Mr. Liddy, but I think you would admit the possibility that railway operations could be over-charged or under-charged, and that consolidated statements might help the regulatory body?

A. May I point out to you Moody's Manual that has been dragged out here two or three times; <sup>and</sup> such a situation would be publicized throughout the length and breadth not only of Canada but of America, for all investors to look at. I just cannot imagine a situation like that existing.

Q. Well that is on the basis, Mr. Liddy, that it just wouldn't happen. You say the consolidated statements wouldn't be any help to the regulatory body?

A. No, they <sup>have</sup> all that information now.





Q. Now, Mr. Liddy, I referred you to section 20 of the Interstate Commerce Commission Act, in connection with depreciation; that all deals with uniform accounting generally. Have you examined section 20 with respect to accounting and reporting in the Interstate Commerce Act?

A. No, I haven't examined it carefully, Mr. Covert. I have read it at times.

Q. My understanding was that the expression was used that the dove of peace had settled and the provinces and railways generally agreed that there should be uniform accounting. I just want to clear up a few things for the record. One: you would agree, Mr. Liddy, that the Board of Transport Commissioners should have the power to prescribe the manner and form in which reports are to be made?

A. Yes, I agree with that.

Q. And to provide that the reports should give an account of the affairs of the carriers in such form and detail as may be prescribed by the Commission? J

A. I think that is required.

Q. And the Board should be able to prescribe a uniform system of accounts applicable to any class of carriers, subject to the jurisdiction of the Board?

A. Any class of carriers? Would you mind explaining that to me?

Q. For instance, they might have a different system perhaps for the smaller railways. I think you felt that that perhaps should<sup>all</sup>/be on the same basis, but do you not think the Board should have the power to decide that?

A. I would be willing to leave it to the Board.



Q. And they should have the power to prescribe the period of time within which the railways shall have this uniform system and the manner in which they are to be kept?

A. Yes; we might be able, informally, to do a little better than that.

Q. In sub-section 5 of section 20 of the Interstate Commerce Act, I think it provides that it will be unlawful for a carrier to keep any account, record, etc. contrary to any railway regulations or orders of the Commission. From an accounting point of view, I wondered if you thought there should be a similar provision in the Railway Act.

A. I don't know the origin of that, the history of it. It seems most unusual. We keep a lot of statistics in the Canadian Pacific.

THE CHAIRMAN: Q. I beg your pardon.

A. We keep a lot of statistics in the Canadian Pacific that are not in the I.C.C. classification.

Q. Would this be something for the protection of the investing public?

MR. COVERT: I expect so, Mr. Chairman. In other words, I think they want them all on the same basis and no other basis.

Q. You don't think that is necessary in Canada, Mr. Liddy?

A. I see no necessity for it in Canada.

Q. Now without getting into a discussion of the question as to whether or not the express business and its assets should be considered as rail or non-rail, I want to ask you if it would not be quite practical, provided uniform regulations are laid down, to consolidate



the accounts of the express company with those of the railway company for the purpose of reporting to the regulatory body, even though separate corporate accounts were prepared for submission to the shareholders with respect to the companies?

A. A quick answer, I would say yes. There is nothing binding on our report to the Board, but I have many other reasons why I think it should not be done, of course.

Q. You say you have other reasons why it should not be done?

A. Yes.

Q. Perhaps you have given those to us already?

A. Yes, I think they are all on the record.

Q. Mr. Liddy --

A. You see the Board of Transport Commissioners will probably wish to make a separate classification of accounts for express companies, just the same as they would wish to issue a railway classification of accounts, and thus get uniformity between express companies in the same way as they would attempt to get uniformity between railways.

Q. I put it to you as a business man, Mr. Liddy, if you wanted to find out about a company's operations, and that company had subsidiaries, you would like to see not only the balance sheet of the parent company and the balance sheet of the subsidiaries, but you would also like to see a consolidated account?

A. Well now, a shareholder in the Canadian Pacific, for example, has certain rights. He has a certain equity, and the accounting that we follow is

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exactly tuned to his rights and his equity.

Q. I don't think that answers my question, Mr. Liddy. I will put it to you this way: as a shareholder of a parent company, wouldn't you want to see a consolidated account, a consolidated balance sheet, and a consolidated profit and loss statement, if the company in which you held shares owned many subsidiaries?

A. We will take the biggest one the Canadian Pacific has, the Consolidated Mining and Smelting Company.

THE CHAIRMAN: Q. What is that?

A. Take the biggest we have, the Consolidated Mining and Smelting Company. If I wanted to see anything about the Consolidated Mining and Smelting Company I would go to their own Annual Report. If I am a shareholder in the Canadian Pacific -- if I was a shareholder, and as a shareholder of the Canadian Pacific, I want to know the affairs of this company. . .

MR. COVERT: Q. If you are a shareholder of the Consolidated Mining and Smelting, you may be able to see the report of the Consolidated Mining and Smelting but if you are just a shareholder of the Canadian Pacific perhaps you cannot?

A. What company have you in mind?

Q. I have no company in mind, Mr. Liddy, and that is the point: I just asked you a question as an ordinary business man or as a shareholder of a company which owned subsidiaries. Do you not think you would need to see a consolidated report to know what the true picture of the company is?

A. I would say I would go to a source such as Moody's Manual, which gives --



Q. Now just a minute; could you not answer that question? If you have to go to another source/<sup>does</sup>that not mean that you really would like to see a consolidated report?

A. Well, it all depends; I don't know.

Q. We cannot agree on that?

A. I don't --

Q. That you should have a consolidated report?

A. I don't think I could.

THE CHAIRMAN: Q. What would be your objection to the making of a consolidated report? What harm would it do?

A. Well, sir, a consolidated report would put on the assets side the assets of the Consolidated/<sup>Mining</sup>and Smelting Company?

Q. Well, yes.

A. Now, we don't own all of that Consolidated Mining and Smelting Company; we only own fifty-one per cent, and all the interest of the Canadian Pacific --

Q. That would appear from the accounting.

A. Not if you combine it, sir.

Q. I have in mind an account that would show the true relation between you and your subsidiary companies?

A. I think its relationship should be shown, and our report does show that.

Q. It does?

A. Our report indicates clearly -- look at the list of companies that are shown here.

Q. I have not seen it.

A. It shows the holdings of the Canadian Pacific in all of these companies. I am simply saying that if you are interested in the ramifications of the



parent company, the Canadian Pacific and these other companies, there is a ready source to go to.

Q. Why could not the company provide the information?

A. Well, sir, we would have to have a report that big.

Q. I don't mean in a report, but these different reports of the different companies which are subsidiary to it. Supposing a shareholder in the Canadian Pacific wanted to know more about the Consolidated Mining Company, why couldn't your company give him all the information? As a company you <sup>would</sup> know that, because of his interest in it?

A. Well, we may know a lot about Consolidated Mining and Smelting . . .

Q. You could send him a copy of their report?

A. Yes, we could send him a copy, but <sup>what</sup> we do in those cases, sir, is to refer him directly to the Consolidated Mining and Smelting Company, because they have their own general manger, they operate their own properties, and they are out on the ground; if that individual wants to ask a specific question of how much lead is in any of those mines out there, let him go and ask the people who know; a railroader doesn't know.

Q. You say you do refer him to them. To your knowledge, has he any trouble in getting information from them? You say you do refer inquiries to them?

A. Yes. I haven't heard any complaints, sir. We send out a hundred thousand copies of the Canadian Pacific Annual Report to individuals, each year.

MR. COVERT: Q. Now, Mr. Liddy, I want to





ask you was it in 1937 that the committee of the two railways was set up to discuss the question of uniform classification of accounting?

A. I think that was the time.

(Page 17424 follows)



Q. Do you know of whom the committee was composed? Was it representatives of both railways ?

A. The comptrollers of both companies, and the small railways were represented by I believe it was Mr. Riddell of the Railway Association -- I have forgotten his title -- Secretary, Secretary of the Railway Association of Canada, representing all the small railways. There was also Mr. Wrong of the Dominion Bureau of Statistics, and a representative from the Department of Transport.

Q. Now, they were working and did work on that, I suppose, until the war; is that right?

A. Yes; the war curtailed their activities.

COMMISSIONER INNIS: Q. Who was the Chairman?

A. Mr. G. S. Wrong, I believe, was the Chairman. I was not on that committee.

MR COVERT: Q. Then nothing has been done since the war; is that correct?

A. Well, we have been trying to get some freight increases since then.

MR FRAWLEY:        Been getting them, too.

MR COVERT: Q. Let us just deal with the committee, Mr. Liddy. Nothing has been done by the committee since the war?

A. That is right.

Q. So I suppose they worked for two or three years and made some progress?

A. I could not tell you the exact length of time. It was a time,        and they did make some progress, I believe.

Q. Certainly they did not end up with a uniform classification suitable to both roads?

A. Well, they did not have a referee, I guess.

Q. That is what I wanted to point out to you; that would indicate that a referee was necessary?



A. I think that committee's activities show the need for a referee.

Q. Now, Mr. Liddy, there were a few general questions that I wanted to ask you. You will recall that you dealt with traffic density, and there was an exhibit filed showing the traffic density of various lines on your system?

A. On two bases, yes, sir.

Q. Most commercial enterprises have what they consider under average conditions to be a break-even point as regards volume or business or sales, and so on?

A. They may have decided that.

Q. Now, do you know if the railways have any such break-even point as far as traffic volume is concerned?

A. I have not heard it discussed as such, but I would not say that it did not exist.

Q. You don't know?

A. But it would vary, you know, for every individual railway.

Q. Yes. Now, do you know, Mr. Liddy, whether you do prepare any information or statistics as to the relative profitability on any line, or how they arrive at whether or not the construction of a new line is desirable or apt to be profitable, or am I taking you out of your field?

A. You are taking me out of my field, but I could say that we have the Department of Development, Canadian Pacific, and studies of that kind would be made by engineers and others to canvass the prospects of a new line.

THE CHAIRMAN: Q. Mr. Jefferson is not in charge of that department?

A. No; but they no doubt would consult somewhere in the plan Mr. Jefferson.

THE CHAIRMAN: You remember, Mr. Evans, the question was raised before.





MR EVANS: Yes; Mr. Newman -- you are speaking of the Department of Research; are you?

A. For the development of new lines, Mr. Evans.

MR EVANS: Oh, for development of new lines-- I do not know that.

THE CHAIRMAN: What do you say, Mr. Evans?

MR EVANS: I thought he was talking about the Department of Research, and I was going to say that was Mr. Newman's department; but he is speaking of another department.

COMMISSIONER INNIS: Q. Who is head of that Department of Development?

A. Mr. Ommaney.

MR COVERT: Q. How do you spell his name?

A. O-m-m-a-n-e-y.

MR EVANS: Q. To whom does he report, do you know?

A. I do not know, Mr. Evans.

MR EVANS: We will find out that.

MR COVERT: Q. At page 16791 of the transcript -- I do not think you will need to refer to it -- dealing with the density chart, you showed that 47 per cent of the C.P.R. lines are in the red category shown on the exhibit, 29 per cent in the yellow, and 24 per cent in the red---

THE CHAIRMAN: You said "red" twice. Do you mean green?

MR COVERT: Yes.

THE CHAIRMAN: Red, green and yellow?

MR COVERT: That is right. I think I should have said green for the first one, Mr. Chairman -- green, yellow and red.

Q. In this exhibit that was put in by the Canadian Pacific, Exhibit No.191, in using the colours there I think you have used them on the same basis as the chart put in and



attached to the Canadian National brief, Exhibit A?

A. Yes. One is a blueprint and the other is white paper.

Q. No, no, but I mean your green would have the same meaning as the green on the Canadian National?

A. Yes; we made that to correspond.

Q. Yes, you made the two to correspond; and the same with the red and the yellow. According to my calculations, on the Canadian National 45 per cent approximately would be green as against your 47, 30 per cent yellow as against your 29, and 25 per cent red as against the Canadian Pacific 24.

A. The figures I have in rough here are, for the Canadian National, 45, 31 and 24.

Q. 45 and what?

A. 45, 31 and 24.

Q. Then your mathematics are probably a little better than mine.

COMMISSIONER INNIS: What year is that?

MR COVERT: That was 1948.

THE WITNESS: 1948.

COMMISSIONER INNIS: The figures on the chart are 47, 29 and 24.

MR COVERT: That is the Canadian Pacific.

COMMISSIONER INNIS: Oh, this is the Canadian National; I am sorry.

MR COVERT: I assume that Mr. Liddy apparently made the same calculation that I did, and we arrive at approximately the same results.

Q. Now, that indicates a remarkable similarity between the two lines as far as traffic density is concerned, Mr. Liddy?

A. Particularly the light lines, yes, sir.



Q. I just wanted to find out if you thought that that was a fair indication that, generally speaking, the lines are comparable?

A. The total system, you mean?

Q. Yes.

A. Well, that is quite a problem, Mr. Covert.

Q. I just wanted to know if you thought that that meant that you have about the same proportion of the various categories of line as far as density of traffic is concerned?

A. Yes, I think on the whole that that would mean that. I think in my evidence I did point out perhaps that a lot of the Canadian Pacific red lines, the mass of them, were in the Crows Nest territory.

Q. Yes?

A. That is, perhaps they are even a little worse than the density figures would indicate. If you have a line built in a territory in which your rates are low, that won't show up in your tabulation of volume in ton miles, that low rate, the effect of the low rate. The low rate would be superimposed on that low traffic volume.

Q. Yes, I follow that, Mr. Liddy, but I just wanted to deal with the traffic volume itself at the present. I wondered if you thought that the Canadian Pacific had anything that would be comparable say with the Hudson's Bay Railway?

A. No. That is not in the Canadian National.

Q. That is not in their chart?

A. I do not think it is in their chart, and I do not think it is in their operations either.

Q. Is the Newfoundland Railway in there?

A. Yes; that is part of the Canadian National 24 per cent low traffic lines.





Q. Well, would you think that you had anything comparable to that?

A. I would really have to know what density is on that Newfoundland Railway to answer that question. It is a narrow-gauge railway, of course.

Q. Now, I think I have just three more points to take up with you, general questions. I would like you to look at Exhibit 190 again, Mr. Liddy. On this you show the growth in railway investment through the years, and also the changes in the capital stock and long term debt. In the early years increases in capital stock and long term debt seem to bear a fairly close relationship to the increase in rail property. For instance, if you take the period from 1900 to 1916, you have rail property increases from \$292 million to \$787 million, an increase of about \$495 million; and during the same period your capital stock and long term debt increased from \$221 million to \$584 million, or an increase of about \$363 million.

A. A little less than the property investment.

Q. Yes. Then from 1916 to 1928 your investments in rail property increased from \$787 million to \$962 million, an increase of about \$175 million. Then your capital and long term debt increased from \$584 million to \$749 million, or an increase of \$165 million.

THE CHAIRMAN: What column are you referring to -- long term debt?

MR COVERT: I have taken capital and long term debt.

THE CHAIRMAN: Yes, I see.

MR COVERT: Q. In the next ten years, from 1928 to 1938, the situation appears to be a little different. For example, the investment in rail property increased from \$962 million to \$1,026 million, an increase of only \$64 million, whereas your capital and long term debt increased



from \$749 million to \$999 million, or an increase of \$250 million?

A. Yes.

Q. Now, during the period from 1938 to 1948 the investment in rail property is almost unchanged, whereas the capital and debt had decreased from \$999 million to \$869 million; that is \$130 million. Now, I wondered if you could tell the Commission if there is any particular reason for the change in the trend, or any particular explanation?

THE CHAIRMAN: You have been adding up only those two last columns, have you, under long term debt?

MR COVERT: The capital and long term debt.

THE CHAIRMAN: And the long term debt.

MR COVERT: Yes.

THE CHAIRMAN: I see.

THE WITNESS: I would need to know the non-railway assets before I could give you an intelligent answer on that. It is not on this exhibit.

THE CHAIRMAN: Q. I beg your pardon?

A. I would need to know the non-railway assets. That is, this Exhibit 190 only shows the railway, and he is matching up against that all our capital stock and long term debt.

MR COVERT: Q. The explanation, Mr. Liddy, might lie there; that is probably where it does lie?

A. Well, I am not sure whether it all lies there or not, but---

COMMISSIONER ANGUS: Q. Are you taking into account the depreciation figure?

MR COVERT: I think that would explain, Dr. Angus, perhaps, the later period.

THE CHAIRMAN: What's that?



MR COVERT: I say the depreciation might explain the very different change that occurred say from the period 1938 to 1948.

THE CHAIRMAN: That is, in the net railway property investment -- is that what you are referring to, or both?

MR COVERT: In both, sir.

THE WITNESS: Yes, the depreciation explains some of it, but the depreciation in this statement does not start with 1940 or any year like that. It goes right back to 1920, Mr. Covert. Mr. MacPherson I think had a misconception about this statement. We took our depreciation and spread it all the way back in the years in which we claimed such depreciation for income tax purposes.

MR COVERT: Q. Now, Mr. Liddy, there was one point that I did think should be perhaps evened up on the record, and that was, when there was a discussion of a dividend of 10 per cent on par, yielding 40 per cent on the actual investment made by the shareholder. I suppose it is only fair to point out that when you sold shares at a premium the holder of those shares really received much less on his investment?

A. Yes.

Q. For instance, 5 per cent might mean approximately 3 to him?

A. That is right. He pays \$150 for a \$100 share.

Q. And on the average throughout on your whole common stock, the whole common stock capital, the payment is less than 5 per cent?

A. Yes, on the basis of the money paid in.

Q. Yes.

A. Oh, yes, much less. Yousee, we have -- I think one of my exhibits did give that. There was a premium of





\$77 million over the years.

MR EVANS: \$78 million.

THE WITNESS: \$78 million, is it?

MR COVERT: \$78 million.

THE WITNESS: Yes, it is in Exhibit 190.

\$77,166,226 is the premium paid over the years, and that takes care of the discount of the early stock that was sold in the early days, so that many people paid more than what this \$77 million would indicate.

MR COVERT: Q. Now I want to ask you another question on this business of dividends on capital. Do you think that the fixing of the general level of freight rates on the basis of a rate base would tend to stabilize rail earnings or the return to investors in rail securities?

A. Yes, I think so. I think it has had somewhat that effect in the United States.

Q. Now, if this would tend to stabilize earnings or the return to the investor, would it be reasonable to expect that the shares of the company would sell at a lower yield than the 7 per cent mentioned as being a fair return? I am thinking, for instance, of the utilities generally in Canada like Bell Telephone and so on. When they are on a rate base and rate of return, and there is stabilization of their return, then generally their stock sells well and at a low yield?

A. Yes. I think if we have permanency in the yield that that would be very beneficial.

Q. And you consider that desirable?

A. Oh, yes, very desirable.

COMMISSIONER ANGUS: Q. Would that stabilization of which Mr. Covert has spoken depend on fairly frequent rate revisions?

A. Well, of course we cannot look into the future too



far, Dr. Angus , but I do not envisage many of those; only in times when price levels are disturbed.

THE CHAIRMAN: Q. Are disturbed, do you say?

A. Disturbed, yes.

COMMISSIONER ANGUS: Q. I wonder if there were another case -- suppose that you were carrying out an investment programme, increasing your investment year by year for a period of five years, wouldn't that change your rate base each year?

A. A great deal of that investment, sir, would be perhaps to get some new traffic, and perhaps to make economies; it would not quite appear so severe as a five-year gross programme might on the surface.

Q. No; I understood when we had some figures about that that it showed some substantial increase in earnings in the later years?

A. Yes.

Q. In the earlier ones wouldn't there be an increase in your investment figure without very much in the way of economy of operation?

A. Well, I am not too familiar with that particular programme, except I know a programme should be on the way, and I think a following witness will be able to give you more details of that programme.

Q. Well, let us make the question quite hypothetical, then. If the investment were to increase substantially without any immediate increase in the returns at the existing level of freight rates, would that mean that there would have to be a freight rate revision?

A. Not necessarily. It would be a matter of judgment as to whether the railways felt that they should wait a little while until that investment began to earn its fair return.

Q. They might as a matter of judgment relinquish this



stability that Mr. Covert has been speaking of?

A. I think they are business people, yes, sir.

MR COVERT: That was the question that I was going to ask. That concludes my examination.

COMMISSIONER INNIS: Q. I would like to ask one question on which I am not certain you made any firm statement. Paragraph 54, on page 109 of the C.P.R. brief says -- I do not think you need to bother looking at it; you remember it:

"Nevertheless Canadian Pacific would be deeply concerned in any reduction in the fixed charges of Canadian National unless the principle is recognized that Canadian National should be permitted to earn a reasonable return on a reasonable level of railway property investment."

Now, has the Canadian Pacific thought more specifically on that question as to what a reasonable return to the Canadian National would be, and what a reasonable level of property investment in Canadian National would be?

MR EVANS: If you are looking at me---

COMMISSIONER INNIS: Whoever likes to answer.

MR EVANS: I have not given any thought to it.

THE WITNESS: No, I think we were thinking of principles there, Dr. Innis, rather than specific figures.

COMMISSIONER INNIS: It seems to me it would be extremely useful if one knew more precisely what the Canadian Pacific had in mind in that general statement.

MR EVANS: I can tell you what they had in mind. They had in mind quite clearly that as long as the Canadian Pacific were not threatened by what was done, they would expect proper and reasonable principles to be applied, and they would have little to say about it.

COMMISSIONER INNIS: What would be your idea of a





threat?

MR EVANS: Well, our principal fear of a threat would be this: If the capitalization of the Canadian National were reduced in the absence of some specific provision that a reasonable return would be allowed on a reasonable level of property investment, to be left to the Board presumably, then the danger would be that pressure would be brought to have the Canadian National looked at as the only yardstick, and their requirements, which would then be reduced by the reduction in the fixed charges, set as the measure of the relief the Canadian Pacific would get. Now, that would of course, conceivably, put the Canadian Pacific in a position where it could not live, and that is the threat we see in something that does not provide the protection which that language suggests. But, far from expressing a definite view as to what the Board should find as a reasonable level of property investment or as a reasonable level of return, we do not, as long as the principle is established that they will do it. Then we do not think it is too much our business to say to the Canadian National or to the Board, "This dollar or that dollar should be or should not be in." We might perhaps be interested to the extent of being heard before the Board, but as a matter of principle we do not at this stage attempt in any way to say what should or should not be in, because, frankly, I do not think it would be fair for us to suggest; we do not know enough of the facts. Our friends have got to establish that before the Board, and I think they are quite willing to do so.

COMMISSIONER INNIS: But in establishing it you would be very anxious to have some indication as to the specific figures and as to the possible threat to your position.

MR EVANS: So far as that was necessary to establish



reasonableness. We would want the Board to be satisfied that what they were doing was reasonable. Having regard to that, I do not think we would be too fussy about detail, but we would be interested in the broad principle of reasonableness.

COMMISSIONER INNIS: But if they came along with a specific rate of interest which meant a reasonable return, and came along with specific figures as to railway property investment, then you would be very much interested in knowing how that was arrived at.

MR EVANS: We would want to know that reasonable principles were applied in getting to it. I do not think I can say further than that. For example, you might suggest this, just as a rough example: Supposing it were said that a particular line should not be allowed to earn any return on the investment in that line; now, if the reasons for excluding that were not what the Board would consider reasonable or what we would consider reasonable, we might suggest, well, we have a comparable situation, and we cannot exclude that of necessity; we think that the railway company, the Canadian National, should be allowed a return on that line. I can quite see that there may be matters in which we would be interested, but we certainly have not at this stage anything to offer.

COMMISSIONER INNIS: I am thinking of a situation in which the Board might decide that the Canadian National Railway investment statement would be the yardstick. Now, that would mean that the yardstick should be set presumably so that your position would be comfortable.

MR EVANS: I would not say that it should be set so that we would be comfortable. We say that it should be set on a reasonable accepted principle. Not that some -- to use a word that I should not perhaps use in this context



-- some pressure would be brought to bear for political reasons to exclude something or other, because then that would bring the same pressure to bear indirectly on us. But as long as reasonably acceptable principles of determination of rate base and return are applied to them, we are not going to---

COMMISSIONER INNIS: But surely the comfort of your position becomes a factor in determining.

MR EVANS: Yes, sir, it does; but I do not think we could take a dog-in-the-manger attitude, and say that because we are uncomfortable in this position we have got to have special relief. I think we have got to compete with the Canadian National, as long as it is on a basis of equality with us. Unless the Canadian National were heavily subsidized here and there, then we are quite free of any objection. We are prepared to compete with them, and they with us I assume, but if you take something and give them a privilege which makes that competition unequal, then it is a matter of concern to us.

THE CHAIRMAN: Your position is set out, I think, quite fully in the following paragraph, paragraph 55.

MR EVANS: Yes, sir.

THE CHAIRMAN: We have been dealing with 54 all along. Whatever yardstick is used, you say that the rates fixed must be at such a level as will enable the Canadian Pacific to earn sufficient to provide a reasonable return on its property investment. Unless that is done, it can no longer as a privately owned enterprise attract to it the capital needed in its business.

MR EVANS: Yes. I think Mr. Walker put it quite clearly in his evidence in chief. I would not attempt to paraphrase it, but I think he put our position quite clearly, sir -- better than I could now, speaking from memory.





COMMISSIONER ANGUS: Do you think there is a fundamental difference between a privately owned railway and a publicly owned railway in this, that, other things being equal, the privately owned railway would like its rate base to be as large as possible in order that its return may not look too high, while the publicly owned railway would prefer its rate base to be as small as possible in order to maintain the morale of its employees by saying that it is earning a good return on it?

MR EVANS: Well, sir, that is a very difficult question for me to answer, but I would say this, that I think the Canadian Pacific as a company feels that the Canadian National has shown that it can be efficiently operated. Now, it may be that in determining their rate of return you might give different considerations because of their not having equity capital, as it were, which had to have a return, if you were fixing it alone, but I think you would have to have this in mind, that if you fixed the return for the Canadian National on a basis that represented we will say the cost of money guaranteed by the Dominion Government, and that alone, without regard to the need of a private company for equity capital with a higher return, you might do us the kind of harm I see as possible; but I prefer not to---

COMMISSIONER ANGUS: I meant this, Mr. Evans: If the net income of the company is a function of the rate base and the rate of return, would not the publicly owned company quite naturally rather like to say, "We are earning just the same return as the privately owned company. The rate of return is the same, but of course our rate base is not as high.

MR EVANS: Well, I cannot say what they would do, but I would not agree that that necessarily follows. It



seems to me that you do accomplish the thing you strive for when you provide a return which is adequate for their needs, and if their needs are determined by debt capital guaranteed by the Dominion, then I would expect that the morale situation would be taken care of if they got a return adequate to pay that; but in order to be fair to us, and assuming equal efficiency and an equal level of investment per mile, you would soon put us in a position where we could not compete with a private company at all.

---The Commission adjourned at 1:04 p.m., to meet again at 2:45 p.m.



AFTERNOON SESSION

THE CHAIRMAN: Very well, Mr. Evans.

MR. EVANS: I have a very short re-examination, my lord, but before I begin may I answer a question I undertook to answer to Dr. Innis. The Industrial Development Department, which the witness was speaking about, does report to Mr. Jefferson, the Vice-President of Traffic.

Then before I proceed, in connection with some questions that Mr. Covert asked about the protection -- I suppose "protection" might be the word.

THE CHAIRMAN: Did you say "protection"?

MR. EVANS: The protection which the public might get against imprudent transactions, such as the Joint Facilities Agreement with the Toronto Terminals. I just want to give the Commission reference to two sections in the Railway Act.

Under section 151 of the Railway Act, agreements for sale, lease, and amalgamation require the approval of the Board of Transport Commissioners and the sanction of the Governor-in-Council. There is no limitation put upon the Board's right to approve or disapprove of these agreements. I was thinking more particularly in that connection of the rights of railway property, where the terms might be unusual or improvident, if any suggestion came before the Board under that section; I suggest to the Commission that the terms of that agreement would be subject to investigation before approval was granted.

Now, under section 154 we have the different kinds of agreement. Under 154 the kind of agreement

# THE HISTORY OF THE

REIGN OF KING CHARLES THE FIRST

IN THE YEAR OF HIS AGE SIXTYEIGHT

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FROM THE YEAR OF HIS AGE SIXTYEIGHT

UNTIL HIS DEATH IN THE YEAR OF HIS AGE SIXTYEIGHT

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that was made with the Toronto Terminals Railway Company would be subject to the approval of the Board.

THE CHAIRMAN: That was done, was it?

MR. EVANS: Whether it was done by statute . . . it was either done by statute or had to be done under 154. I have not got sufficient information about that point.

THE CHAIRMAN: You could easily find out, of course.

MR. EVANS: My recollection from a memorandum I have about the Toronto Terminals Railway is that there was no mention of specific approval made. I assume it was done under section 154. It had to be done under one or the other. It provides, under the first section, whether for lease or amalgamation, or under 154, for traffic and running rights--- The sections provide for publication of the notice of application for approval.

THE CHAIRMAN: Must the shareholders be consulted?

MR. EVANS: Yes, the shareholders must approve too. Under 154, the running rights agreement, the Board can dispense with the consent of the shareholders, but under the other section, 151, the agreement for sale, lease or amalgamation, there is provision for shareholders' approval.

THE CHAIRMAN: You see, section 154, sub-section 2, is divided into clauses (a), (b), (c), (d).

MR. EVANS: Yes.

THE CHAIRMAN: Then I see it goes on to say,

" . . . subject to the like consent of the shareholders . . . "

Do you see that?

MR. EVANS: Yes, but under sub-section 3, I



think it is,

"The Board may, notwithstanding anything in this section, by order or regulation, exempt the company from complying with any of the foregoing conditions . . ."

THE CHAIRMAN: Yes, I see that.

MR. EVANS: Where it is done in the usual course of business—I think the section indicates that the Board may only waive those provisions if it is done in the course of ordinary business of the company.

THE CHAIRMAN: That is what it says here: The Board may waive these provisions,

"with respect to any such agreement or arrangement made or entered into by the company for the transaction of the usual and ordinary business of the company . . ."

MR. EVANS: Yes.

THE CHAIRMAN:

". . .and where such consent of the shareholders is deemed by the Board to be unnecessary".

MR. EVANS: Yes.

THE CHAIRMAN: In other words, you must get the approval of the shareholders and the sanction of the Governor-in-Council.

MR. EVANS: Yes, but the Board can waive the consent of the shareholders if it deems it to be in the ordinary course of events.

THE CHAIRMAN: Yes.



S. J. W. LIDDY RECALLED:

RE-EXAMINATION BY MR. EVANS:

MR. EVANS: Q. Mr. Liddy, there was a good deal of discussion throughout your cross-examination, and particularly in Mr. Covert's examination of you, about the question of uniform classification of accounts; and I think the impression was left in the course of Mr. Covert's examination that there was something less than absolute uniformity, if one railway company should have one method of depreciation and another should have a different method. What do you say about the possibility, for example, of obtaining an absolute uniformity of accounts having regard, say, to pensions?

A. I would say it would be impossible to have absolute uniformity for pensions.

Q. Why?

A. Unless you had identical pension plans and pension benefits.

Q. Well, is that the case between the Canadian National and the Canadian Pacific?

A. No, our pension plan -- the Canadian Pacific pension plan is not the same as any of the pension plans of the Canadian National, as I understand it.

Q. So that what you are saying is, that while the accounts as a classification of accounts might be different, the results would reflect the effect of these different plans. Is that your view?

A. That is right sir.

Q. Now on this question of the Toronto Terminals, the suggestion was made that the rental paid by the two companies to the Toronto Terminals Railway was a charge to

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expenses, and there was also rather a suggestion that the income derived by the Canadian Pacific from its holding of the bonds of the Toronto Terminals Railway Company might be put into railway revenue. May I ask you this: what would you say as to the result from the standpoint of the freight shipper, if that were done?

A. The freight shipper or the user of the railway transportation would then be enjoying the use of a facility without charge.

Q. Why do you say that, Mr. Liddy?

A. Because the debit of the rental from the Toronto Terminals would be offset by the credit that the Canadian Pacific and the Canadian National get. You see, Mr. Evans, there is no property investment in the Canadian Pacific account. That lies under the Toronto Terminals' own individual investment; and all the Toronto Terminals do is to add<sup>up</sup>/their expenses and add up their bond interest and dividends paid to the two railways. If the Canadian Pacific or Canadian National were to re-credit that again to the freight account or to the railway account it would wash it out, and there would neither be any property nor any charge.

Q. I see.

A. And yet the benefit of all transport revenue remains in the railway account.

Q. Now we turn to the question of depreciation, at page 17367. During, I think, Mr. Covert's examination of you this question and answer appear near the bottom of page 17367 of the transcript:

"Q. That is, you do not consider that after so much use the lifetime of an asset has expired, do you? That is, taking a locomotive you do not say, 'Well now, after



it has travelled so many miles that is the end of it.' It may take ten years to do that, or it may take twenty, or it may take thirty?

A. That is right; and usually in its old life it runs along with small use. It may take five years in the last stage of its life <sup>to make the same mileage</sup> /that it makes in its first year of life."

Now then, just to point that up a little bit. Would you tell the Commission how the straight-line method reflects, if it does reflect, the marginal use of equipment in those latter years of its life that you speak of there? Is there any change in the accruals of depreciation under straight-line method which would involve marginal use of equipment?

A. No; the straight-line method would charge the same amount in the last year of the life of an asset as it would in the first year of the life of an asset, which would mean that when, say, equipment is making very small mileage, maybe only used, say, on week-ends or some infrequent service of that kind, that there would be charged against the freight account or against the railway account just as much for the use of that equipment in the way of depreciation <sup>as</sup> /in the first year when intensive mileage was used.

THE CHAIRMAN: That of course is inherent?

MR. EVANS: Yes.

THE CHAIRMAN: That is what straight-line means?

MR. EVANS: Yes.

Q. To elaborate on that, may I put this to you: if for example in a year of very low traffic volume half of your equipment was on sidings unused, in what way would straight-line reflect that condition?

A. The straight-line would take <sup>no</sup> /recognition of that



situation. For example, Mr. Evans, suppose that to handle the western grain crop there were a lot of cars stored; they might never be used except for one or two months of the year, in such a year, in contrast to another year in which freight cars are used intensively throughout the year. The straight-line method would assess the same charge irrespective of traffic conditions.

Q. Now what about the user method?

A. The user method tunes the charge to the use being made.

Q. That is it reflects in the charges the actual mileage made by the sum total of the equipment in use?

A. Correct.

Q. And if half of the equipment were not in use . . .?

A. Then the depreciation is accruing only on half of that equipment, if the mileage is normal.

Q. Mr. Covert, at page 17369, near the bottom of the page asked you this question:

"Q. You think, for example, that the Board of Transport Commissioners would be in a position to deal with these, to test these tools that you use? For instance, I think you mentioned the curve of survivorship, or the survivor curve?

A. The survivor curve and growth trend curve.

Q. You think they are fully equipped, for instance, to test and police that?

A. I see no difficulty at all."

MR. EVANS: Now I would like to file with the Commission, before I ask the question, copies of two





Exhibits that were put in in the 20 per cent case, as an illustration of what can be done to test the user rates. These have been filed, as I say, and our friends have had familiarity with them.

THE CHAIRMAN: Are you making them Exhibits in this case?

MR. EVANS: I thought I might. It might be convenient for the Commission. If there were any objection by my friends I wouldn't bother, but I think it might be helpful to have them.

THE CHAIRMAN: What are their numbers?

MR. EVANS: The Exhibit numbers in the 20 per cent case were (49) 25 and (49) 26; and the Exhibit numbers in this case will be Exhibit 200 for the (49) 25, if your lordship pleases, and Exhibit 201 for (49) 26.

<u>EXHIBIT NO. 200:</u>	Canadian Pacific Railway Company Average Life Expectancy of Equipment as Indicated by Depreciation Rates
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<u>EXHIBIT NO. 201:</u>	Canadian Pacific Railway Company Average Life Expectancy of Road Property and Shop and Power Plant Machinery as Indicated by De- preciation Rate.
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MR. EVANS: Q. Without going into detail --

THE CHAIRMAN: I want to make sure that we have both those Exhibits here.

MR. BELCOURT: Yes, sir.

MR. EVANS: Q. Now, Mr. Liddy, I do not want to go into detail, but would you just run down one of these several columns in this Exhibit and explain to the Commission how that calculation tests the user rate of depreciation?

A. Yes, Mr. Evans. May I say first in connection



with locomotives that the problem is to test whether or not the depreciation rate per mile of 4.1 cents, shown in the sixth line, is or is not a reasonable rate. That is the problem.

Q. Yes.

A. We have in the first problem the ledger value of locomotives as of January 1, 1948, of \$91 million. That is the known figure from our books. We estimate the percentage salvage of those locomotives, which has been taken at  $5\frac{1}{2}$  per cent; that is quite a normal percentage of salvage.

Q. Then you deduct that salvage to get the ledger value less salvage, in the next line?

A. Yes. That then becomes the depreciable value, which is \$86 million.

THE CHAIRMAN: Q. That is \$86 million.

(Page 17450 follows)



A. Yes, that is the amount that will depreciate and disappear over the years. Now, at January 1, 1948, we had in our inventory 1,771 locomotives. That figure is known. By dividing the number of locomotives into the depreciable investment -- that is, the ledger value less salvage -- an amount described here as depreciable investment per unit is arrived at, in this case amounting to \$48,600 per locomotive. Then the next item is the depreciation rate which we have claimed.

Q. There is a rate in effect in that particular year?

A. That is right -- 4.1¢.

Q. That is to say, in 1947, which was the year previous to that?

A. Yes.

Q. You adjusted the rates later, did you not?

A. That is right; but this was the rate we claimed in the freight rates case.

Q. That is right.

A. Now, we want to find the indicated average life in terms of mileage. If every mile that that locomotive runs we are going to charge out 4.1¢, how many miles has it got to run in order to make up for its total cost?

Q. That is to say, this average value of \$48,600?

A. That is right; so we divide 48,600 by 4.1¢ and arrive at a mileage necessary to be run out of 1,185,000.

COMMISSIONER INNIS: How do you get the 4.1 per cent?

MR EVANS: 4.1¢ is the rate they struck for the depreciation on locomotives, and we are testing whether that rate is or is not a proper rate in terms of years.

COMMISSIONER INNIS: This is just an estimate which you have decided on?

MR EVANS: Yes; we struck the rate, and we tested it from time to time in this way, and this is the way we





tested it before the Board.

MR FRAWLEY: I do not think it is unfair to say, in answer to your question, sir, that that was the rate we endeavoured to find out during the course of the revenue cases. We made an application to the Board to direct the company to let us know the details behind that rate, and the Board did not agree with us and did not so order.

MR EVANS: It is only fair to say in return to my friend that the Board said it was fairer to test the thing in the light of experience than to go into the studies behind it.

THE CHAIRMAN: You said something about years there.

MR EVANS: We were testing the user rate to see how it would result in terms of years.

THE CHAIRMAN: Well, in terms of miles it is 1,185,000 miles.

MR EVANS: Yes. Now we have to translate that into years to test it.

Q. Now, Mr. Liddy, in the second half of the statement, will you describe to the Commission how you go about testing the indicated average life in terms of mileage shown on the first half of the statement, in terms of years?

A. Yes. We adopted two tests. One was to take a year that was neither a high traffic volume year or a low traffic volume year.

Q. And you took 1940 on this exhibit?

A. Yes. The year 1940, if you will recall, sir, was a year that emerged after the depression but yet had not got into the high traffic years of the war. So, taking the year 1940, we found that locomotives on the average made 31,000 miles in that year, so that if we divide 31,000 miles into 1,185,000 miles, a life of 38 years is required



in order that this depreciation rate of 4.1¢ may be fully recovered.

Q. Now will you deal with the second test you made?

A. The second test goes to a period of years.

Q. Why did you select that period?

A. The years 1933 to 1946?

Q. Yes.

A. They were selected because the Board of Transport Commissioners itself selected it in one of their judgments.

Q. Was it because they were both low and high traffic volume years?

A. Yes. There were some low years in there and some very high years. Presumably they were trying to get a normal or an average.

Q. And then what was the result of that, will you indicate?

A. The average mileage made by locomotives during those fourteen years was 32,200, and on that basis, by dividing that latter figure into 1,185,000 miles, requires a life of 37 years. Now, our submission, Mr. Evans, was that locomotives lasting 37 or 38 years was obviously a result of a rate of depreciation that could not be challenged as being high.

Q. Then will you turn to Exhibit 201? -- I assume that the same calculation is gone through with regard to freight cars and passenger cars on this exhibit?

A. Exactly, Mr. Evans.

Q. Now, turning to Exhibit 201, which was 49-26 in the 20% Case, will you take the first column there, Depreciable Road Property, and describe to the Commission how you proceeded to test that as a rate?

A. First we have the value of depreciable road property as carried in our books.



Q. With regard to that, I notice a difference between the two exhibits, that you do not allow salvage value?

A. Yes. That value was \$307 million.

Q. Yes, but you do not allow salvage value off that?

A. No.

Q. I just wanted to draw it to your attention.

A. I did not take salvage off that because the percentage of salvage in connection with road property is so small that it would have no appreciable effect on the rate. Usually the cost of gathering up salvage is more than what you would get for it. You would have, for example, concrete foundations. About the only thing that is of salvageable value would be something with steel or iron in it. Now, line 2, Mr. Evans, sets out the depreciation rate as per our accounts which we claimed for the freight rate determination.

Q. And that was \$102 per million gross ton miles?

A. Yes.

Q. Now, what happens?

A. Well, we are trying to test whether that is a reasonable rate. Now, the third line gives the indicated average life in terms of million gross ton miles.

Q. And that is obtained by dividing the 102 into the 307 million?

A. That is right. That is a figure of 3,016,000-odd.

Q. 3,016,000-odd millions of gross ton miles?

A. That is correct.

Q. How do you then proceed to test that and relate it to years?

A. Now, we take the same groupings of years as in Exhibit 200. First we have the year 1940, and in that year





our actual gross ton miles was 46,939 millions.

Q. Yes?

A. Dividing that figure into the 3,016,000-odd up above produces an average life expectancy of 64 years. That is, it would require 64 years of traffic volume such as 1940 in order to make up an aggregate total of 3 million million ton miles.

Q. Now, in the 14-year period, how does that test it?

A. In the 14-year period the average gross ton miles were 50,634 millions, and that figure divided into the 3 million million gross ton miles, which is the third item on the statement, on the exhibit, produces an average life expectancy of 60 years. Now, if we look at those two figures, 64 years and 60 years, as the life that would be necessary in order that the rate of depreciation for road property which we charged against the freight shipper -- if we look at those years and compare them with any other basis, there are obviously long years -- property will not last, in my view, anywhere near 60 years on the average, so that the inevitable conclusion is, as a user rate the figure of \$102 is low.

Q. You are just saying what you said to the Board of Transport Commissioners?

A. Yes, sir.

Q. Now, have you got with you a simplified illustration comparing the way the user basis would work with the straight line basis?

A. Yes. I prepared two simplified illustration sheets which may be of some help, Mr. Evans.

MR EVANS: Could we give those a number, sir?

The one entitled "Comparison of User Basis and Straight Line of Depreciation Basis over the Lifetime of a Locomotive, Simplified Illustration", will be Exhibit 202.



--EXHIBIT 202: C.P.R. Company - Comparison of user basis and straight line basis of depreciation over the lifetime of a locomotive (simplified illustration)

MR EVANS: And the one dealing with road property excluding shop and power plant machinery will be 203.

--EXHIBIT 203: C.P.R. Company - Comparison of user basis and straight line basis of depreciation over the lifetime of road property, excluding shop & Power Plant Machinery. (simplified illustration)

MR EVANS: Q. Now would you deal with Exhibit 202.

I do not want you to spend too much time on it, but just shortly describe what you are intending to show there?

A. As this exhibit states, it is a simplified illustration; in other words, sir, I have taken the frills out of it and left the essentials. Line No. 1 is the ledger value.

Q. That is an average; presumably it is some average that you might strike in the course of your study?

A. Yes, sir. It happens to be the average of January 1, 1949, but it could be any figure, Mr. Evans, for this purpose. Then we take 5 per cent salvage off that ledger value, and then we get the residue as the service or the depreciable value.

Q. Up to that point you have no difference between the user basis and straight line columns?

A. Those are steps that must be taken in both cases.

Q. And then you get your same service or depreciable value in both columns, and from there I notice that the columns differ. Will you deal with that?

A. Yes. Under the user basis, normal annual mileage or average annual mileage must be determined. The Commission may remember that I referred to a growth trend; well, I arrive at a figure of 30,600 there. Whatever the figure is, we will take that for this purpose. Now, under the straight line basis they must determine first the estimated service life in years. That is 34 years in this particular



example. Then if you divide item 3 by item 5 in both columns---

Q. That is, you divide the service or depreciable value by the estimated life in years?

A. Yes.

Q. You get item 6; is that it?

A. Yes, you get item 6, which indicates that the average annual loss in service value to be recovered each year must be \$1,562. Now, the next item, No.7, depreciation rate, 5.1¢ per locomotive mile.

Q. That is on the user basis?

A. In this case, yes. And 2.79 per cent in the case of the straight line.

Q. Then will you say what item 8 is?

A. Well, now I would like to say how we arrive at 5.1¢ and how 2.79% is arrived at. 5.1¢ per mile is arrived at by dividing \$1,562 by the 30,600 normal annual mileage figure. That gives 5.1¢. The 2.79 per cent is arrived at by dividing \$1,562 by the gross ledger value of \$55,900.

Q. Now, you were going to describe item 8?

A. Yes. Item 8 is the estimated service life in miles, and there is a foot-note there, foot-note number 2, is the normal annual use of a unit multiplied by estimated life in years.

Q. In other words, you find your normal annual mileage, you find your estimated life in years, and you get an estimated service life?

A. Yes.

Q. In miles?

A. That is with the refinements eliminated.

Q. Yes?

A. That is essentially, though, the background. Item No.9 shows the depreciation recovered over the lifetime of





asset, which indicates user basis is 1,040,000 miles, multiplied by 5.1¢. It may not come to an equal amount in each and every year, but it will aggregate that amount over the 34 years.

Q. But in this illustration you simply assume an average year?

A. That is right. You multiply the total estimated life of the unit over its entire life in miles -- that is, 1,040,000 miles multiplied by 5.1¢, and you will get, recover, all the depreciable value, and you will do the same by the straight line method. The calculation there is to take \$55,900, that is ledger value investment, multiplied by 2.79 per cent each year, and multiply that by 34 years, and you get \$53,100.

Q. Now, just shortly, without duplicating all that, give the Commission a view of the illustration in Exhibit 203?

A. Exhibit 203 shows the ledger value for road property excluding shop and power plant machinery, of 312 million. The normal annual gross ton miles, developed through our growth trend curve, is 48,800 million. The estimated service life is  $56\frac{1}{2}$  years. The indicated average annual loss in service value, which is item 1 divided by  $56\frac{1}{2}$  years, means that we have to recover on the average each and every year \$5,522,000. The depreciation rate that is necessary in order to do that is arrived at by taking the \$5,522,000 and dividing it by \$48,800.

Q. 48,800 gross ton miles?

A. Excuse me. That will produce a rate of \$113 per million gross ton miles. Then you have the estimated service life of the whole property of 2,757,000 million gross ton miles.

Q. It is the same from there on as the other exhibit?



A. And you multiply that by the rate, and you finally get your total property recovered.

Q. Then I have only one further question to ask you, Mr. Liddy. My friends of the Canadian National were rather curious to know how long it took the accounting department to prepare Exhibit 196, which is Exhibit 49-49 in the 20% Case. Have you any knowledge of that?

(Page 17462 follows)



A. The Exhibit itself, Mr. Evans, may have taken a couple of months, but the work-back was onerous.

Q. Have you any idea how long it would take to do the work that ultimately was used in the Exhibit?

A. That would depend upon how the accounts now stand with the Canadian National.

Q. I was not asking you to estimate the Canadian National. They wanted me to ask how long it took us to get the information that went into that Exhibit.

A. After we had our capital analysis completed, I would say that altogether it took six full months.

MR. MacPHERSON: Mr. Chairman, I understand my friend, Mr. Evans, has now left Exhibits 200 and 201.

MR. EVANS: Yes.

MR. MacPHERSON: I am not objecting at all to them being put in, but in order to save the time of the Commission I propose to ask the Commission to read in conjunction with these two Exhibits the cross-examination that took place in the 20 Per cent Case.

MR. EVANS: I think that is only fair, quite.

MR. MacPHERSON: I think these Exhibits were put in, Mr. Evans, during the evidence of Mr. Dalglish.

MR. EVANS: No, during the evidence of Mr. Liddy.

THE CHAIRMAN: Whose evidence?

MR. MacPHERSON: The evidence of Mr. Liddy in the 20 Per cent Case, and I will give the Commission later the pages at which cross-examination on these Exhibits took place, to save the time of the Commission.

COMMISSIONER INNIS: Was that a very long extract, Mr. MacPherson?

MR. MacPHERSON: I don't think it is very long.





COMMISSIONER INNIS: I wonder, would it be worth filing it as an Exhibit?

MR. MacPHERSON: I will check the evidence and if it is not too long we will have it copied and filed as an Exhibit in conjunction with those.

MR. O'DONNELL: Mr. Liddy may I just ask, we understood you to say it took six months to make Exhibit 49-49 which has been produced in this particular record as Exhibit 190.

A. Six to eight months.

Q. What I wanted to go behind was the further time that it took you to develop particularly the column which is entitled "Net Railway Property Investment" as shown in Exhibit 190.

A. Yes, well, that depends. I have never seen the accounts of the Canadian National in that respect, but if you do your accounts like we do them, by projects, and not in any years at all by this I.C.C. classification, you have got a three-year proposition ahead of you unless you want to use some arbitraries in the meantime.

Q. I understand that with your accounts in the condition they were, by projects, it took about three years to get the information which is in that second column in Exhibit 190, the column entitled "Net Railway Property Investment".

A. Did you know, Mr. O'Donnell that you have got - -

Q. I don't know about our accounts. I just wonder how long it took.

MR. FRAWLEY: This was the first time you had made a split Balance Sheet in the whole course of the Company's affairs. I think you have said that already.

A. Oh, yes, it is the first time. I don't like the word "split".



Q. Split Balance Sheet is what I understand you call it yourself?

A. No, it is a segregated Balance Sheet.

Q. I will have to correct you. The first time I heard the expression was in a letter from my friend.

MR. EVANS: That is my fault, Mr. Frawley, my language.

MR. FRAWLEY: I will take Mr. Evans' language.

THE WITNESS: I just want a little dignity added to it.

MR. FRAWLEY: Here is the dignity I am coming to. The Canadian Pacific has been operating their trains over the mountains since what, is it 1885?

A. Yes, sir.

Q. So it is about six months work out of what?

A. Well, we have been splitting our Balance Sheets all these years or you might not have had the trains operating over the mountains.

Q. We might not have had the Smelters either.

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MR. JAMES C. THOMPSON - CALLEDEXAMINED BY MR. EVANS

Q. Mr. Thompson, you are senior partner, I believe, of the accounting firm of Peat, Marwick, Mitchell & Company?

A. Yes.

Q. Of Montreal.

A. That is correct.

Q. At least they have their offices in Montreal. Now then, to shorten this a bit I will just suggest these things to you. You became a chartered accountant in May of 1920?

A. Yes.

Q. I believe you were a Gold Medallist and you took Honours at the University of Alberta?

A. Well, not at the University, at the C.A. examinations.

Q. And you are a member of the Alberta, Quebec, New Brunswick, Prince Edward Island and Newfoundland Institutes of Chartered Accountants?

A. I am.

Q. And I understand you were elected a Fellow of the Alberta Institute in 1936?

A. Yes.

Q. And an International Associate of the American Institute of Accountants in 1949?

A. That is correct.

Q. And coming to your employment, from 1919 to 1922 you were with the Chartered Accountants firm of Harvey, Richardson, Cole & Robertson of Edmonton and Calgary?

A. Yes.





Q. And then you were with Touche, Niven & Company of New York City between 1922 and 1923?

A. Yes.

Q. And between 1923 and 1936 you were, I understand, Provincial Auditor of the Province of Alberta?

Q. And from 1936 to 1941 you were with Clarkson, Gordon & Company, Chartered Accountants of Montreal?

A. Yes.

Q. And from 1941 to 1944 you formed your own firm?

A. That is correct.

Q. And the name of that firm, am I right<sup>is</sup> James C. Thompson & Company, having offices at Montreal and Calgary?

A. Yes.

Q. And from 1944 to date your position is what?

A. In 1944, I joined the firm of Peat, Marwick, Mitchell & Company as a partner and became senior partner on July 1, 1946, that is, for Canada.

Q. Now then, coming to your public utility experience, while you were in Alberta, I understand that you were ex officio auditor of the Alberta Government Railways between 1923 and 1936?

A. That is correct.

Q. And you were also auditor of the Alberta Government Telephones in the same years?

A. Yes.

Q. And your present firm, do they act for various utilities?

A. Yes, we are auditors of various electric light, gas and power companies, principally in Western Canada.

Q. I see. Now, what was your first rate case, Mr. Thompson?



A. The first rate case was in 1920 or 1921, the Calgary Gas Company v. City of Calgary.

Q. What was your connection with that case?

A. My then firm acted for the City and we established a rate base.

Q. Now, you have acted also in a consulting capacity, haven't you,--I have a note here that you acted as consultant in accounting matters to the Manitoba Government in the Commercial Enterprises survey of 1940?

A. That is correct.

Q. And what did that embrace?

A. That embraced an examination of the accounts of the Manitoba Government Telephones, the Manitoba Power Commission and other governmental enterprises.

Q. And then you also acted as consultant I understand, for the New Brunswick Electric Power Commission?

A. Yes, on three occasions, in 1942, 1947 and 1948.

Q. And then for the Board of Public Utilities Commissioners of the Province of New Brunswick in connection with the New Brunswick Telephone Company Case.

A. Yes, on several occasions, in 1945, 1948 and in 1949.

Q. And then in connection with the New Brunswick Power Company?

A. Yes, acting for the Board of Public Utilities Commissioners, I made an examination of the affairs of the New Brunswick Power Company which was subsequently expropriated by the New Brunswick Government.

Q. That was in 1947?

A. That is correct.

Q. And then had you something to do with the Moncton



Electricity and Gas Company Limited?

A. Yes, in 1949 my firm was asked to examine the rate structure of the Moncton Electricity and Gas Company Limited. One of my partners under my direction carried out that work.

Q. And did that result in a report to the Utilities Commission?

A. Yes.

Q. On rate-making formula, that is to say rate of return on rate base?

A. Rate of return on rate base.

Q. Yes, would you tell me what ultimately resulted from the appeal that was taken from the Board in that particular case?

A. Yes, on appeal from the Board's judgment, the Supreme Court of New Brunswick awarded the Company a 7% rate of return on the rate base as determined by us.

Q. And had your report anything to do with the rate of return?

A. Yes, we suggested 7% would be a fair and equitable rate.

Q. And what did the Board of Public Utilities Commissioners do in their Judgment?

A. They awarded 6%.

Q. I see, and the Court of Appeal raised that to 7%?

A. Yes.

Q. Now then, had you some connection as consulting accountant with the City of Montreal?

A. Yes, I worked for about six months in the Montreal Tramway Rate Case for the City of Montreal.

Q. When was that?

A. In 1948.





Q. Then I understand that since the Railway Association of Canada made the application before the Board in the 21 Per cent Case, you have been acting as consultant to the Association, and in particular to the Canadian Pacific in connection with these rate cases that have been going on for the past several years?

A. That is correct.

Q. And had you some consulting capacity in connection with the Beauharnois Light, Heat & Power Company Limited?

A. Yes, I gave evidence before a Board of Arbitration on the "going concern" value of the Beauharnois undertaking. That was last year, last October.

Q. Was that in connection with an expropriation or something?

A. Yes, the expropriation by the Government of Quebec.

Q. Now then, without going into detail, perhaps you can give me a birds-eye view of some of your public appointments and engagements as a chartered accountant?

A. From 1919 to 1922 I was Secretary of the Alberta Municipal Finances Commission, and on that work surveyed the financial position of defaulting Alberta municipalities. In 1935 I was a member of the Alberta Taxation Inquiry Board on Provincial and Municipal Taxation. From 1938 to 1941 I acted as Director of the Public Accounts Inquiry, Royal Commission on Dominion-Provincial Relations. On various occasions I have been employed by the Department of Finance, particularly in connection with the Dominion-Provincial Conference, 1941, the Dominion-Provincial Tax Suspension Agreement of 1942, the Dominion-Provincial Liquor Agreements of 1943, and the Dominion-Provincial Conference in 1945. I acted for the Province of Quebec in 1940 to determine the



then financial position of the Province. The year before that, 1939 I acted as consulting accountant to the Province of New Brunswick to survey its tax system.

Q. Then had you something to do with the Carrol Commission?

A. Yes, that was 1944. The Carrol Commission was appointed to inquire into the closing down of the Trenton Steel Works, and I acted as Commission accountant.

Q. And then you also had something to do with the Royal Commission on Co-Operatives?

A. Yes, I attended sittings and gave evidence before the Roayl Commission on Co-Operatives in 1945, and, the Royal Commission on the Taxation of Annuities and Family Corporations in 1945.

Q. Then I think you were also, weren't you, Financial Adivser to the Newfoundland Delegation in connection with the negotiation of the Terms of Union?

A. Yes, that is correct.

Q. That was in 1948?

A. Yes.

Q. And then were you also Financial Adv~~isor~~ to the Province of Newfoundland?

A. Yes, in 1949 and at the present time.

Q. Yes, have you had experience in the preparation of various Briefs on accounting matters?

A. Yes, I have. submitted numerous Briefs on accounting matters to the Board of Referees, the Excess Profits Tax Act and similar Boards.

Q. Now then, Mr. Thompson, you gave evidence on behalf of the Canadian Pacific in the so-called 21 Per cent Case and also in the 20 Per cent Case on the subject of depreciation

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A. That is correct.

Q. And I think your evidence will be found in the 21 Per cent Case at pages 14289 - 14656 and pages 15195 - 15195 - 15224, and in the 20 Per cent Case at pages 461 - 469 inclusive?

MR. MacPHERSON: Mr. Evans, does that include cross-examination?

MR. EVANS: I assume so. If it doesn't, it should. I quite agree it should all be there.

MR. SINCLAIR: Yes, it does include cross-examination.

MR. EVANS: As I recall your evidence in the 20 Per cent Case, Mr. Thompson, that was largely devoted to a joint analysis made with Mr. Dalgleish of Montreal, another chartered accountant, in connection with certain deductions made by the Board in the 21 Per cent Case Judgment in respect of depreciation charges?

A. That is correct.

Q. Now then, I understand, without going through your evidence which I don't want to do, that you did give evidence in favour of the user method of depreciation.

A. Yes.

(Page 17473 follows)





Q. Now then, I am not going to take you through that evidence but I want to direct your attention to a statement made by Mr. Morrison, an accountant appearing here for the Province of Alberta. At page 14512 this question was asked Mr. Morrison:

"Q. This is a statement Mr. Dalglish made and I would ask you if you would agree with it: -

'In my view the user basis of depreciation is eminently suitable for railroad accounting because railroads experience violent fluctuations in operation.' "

And the answer given by Mr. Morrison:

"A. Yes, I would agree with that statement, and a similar statement by Mr. Thompson, with my own reservation that I mentioned before, that in my opinion while they are still eminently adapted to those, consideration should be given to the depreciation that takes place when there is no use."

Now, Mr. Thompson, would you give me your view on the reservation made by Mr. Morrison in that answer?

A. Yes. The straight-line method of depreciation in the case of railways provides for depreciation in excess of requirements when facilities are not in use; and conversely, for less than requirements in years of intensive use. In my view the user basis is more realistic, in that it is geared to the use of facilities and distributes the charge or charges more equitably.

Q. Now turning to another subject, Mr. Thompson, the subject of allocation and apportionment of fixed charges and dividends. Mr. Morrison at page 14442 said this:



"Alberta submits that in the case of Fixed Charges there must be an allocation and apportionment between Rail and Non-Rail and in the case of Dividends and Apportionment."

Do you agree with that submission, Mr. Thompson?

A. No, I don't agree with that submission.

Q. What is your view?

A. In my view when you have a rate of return predicated on a rate base, it is not necessary to apportion dividends.

MR. FRAWLEY: Well now, that is fine, but I don't think Mr. Morrison said that when there is a rate base and rate of return, when he made this submission. I think you should particularize, Mr. Evans. I am sure you want to.

MR. EVANS: I am sure my friend can clear up anything he has on cross-examination.

MR. FRAWLEY: Yes, I know, but this isn't a lawsuit. Surely you don't want this thing to go on and on.

THE CHAIRMAN: I understand, Mr. Evans, you are telling Mr. Thompson something Mr. Morrison said?

MR. EVANS: Yes, and asking him if he agrees with it.

THE CHAIRMAN: Have you read it to him?

MR. EVANS: Yes, I read him the section, what he said at page 14442. He was reading, I gather, from the Alberta brief on the subject of accounting, and beginning at page 14441 he deals with apportionment; the little section I read commences on page 14442, in which he submits on behalf of Alberta, or Alberta submits, that in the case of fixed charges there must be



an allocation and apportionment between rail and non-rail and in the case of dividends and apportionment.

MR. FRAWLEY: If you will pardon my interruption again. You see, my lord, what he was talking about is made quite clear at the bottom of page 14441, when Mr. Morrison began his discussion about apportionment. He said:

"As the accounts of the Canadian Pacific Railway have been used as the yardstick in recent rate hearings and because of the nature of the 'requirements' as set out in the applications for rate increases, a method of apportionment of certain of these requirements is necessary."

Now all that Mr. Morrison said is of course predicated upon that opening statement. I have no quarrel with what Mr. Thompson said except Mr. Thompson is going to continue about what you have with rate base and rate of return, and therefore is a criticism of Mr. Morrison, directed at what Mr. Morrison said.. Call it cross-examination if you will, but it occurs to me, Mr. Evans, that you would want to clear that up as you go along.

MR. EVANS: If it is not clear. . . I take it that my friend now agrees that where the Alberta brief says that there must be an allocation and apportionment between rail and non-rail and in the case of dividends and apportionment, that the matter is academic where you have a rate on investment.

MR. FRAWLEY: If you are asking about Alberta says --

MR. EVANS: You are putting this to me, and you could do this on cross-examination. Now if my friend is going to agree with this, I will not ask the





question.

THE CHAIRMAN: Mr. Frawley says: Go back to the basis of it all.

MR. FRAWLEY: That is all.

THE CHAIRMAN: That is not hard to do.

MR. EVANS: Do you want this read, Mr. Frawley?

MR. FRAWLEY: I read the opening paragraph, which is Mr. Morrison's text, you might say, for his further discussion of apportionment - that is all.

MR. EVANS: There is really nothing between us. Then I understand --

THE CHAIRMAN: Except the foundation.

MR. EVANS: I am reading the exact words used by Mr. Morrison. Mr. Frawley may want to argue . . .

THE CHAIRMAN: They were all premised on that general statement?

MR. EVANS: Yes. I do not want to pursue it.

THE CHAIRMAN: Go on. Do you not want to pursue it?

MR. EVANS: I had only one question to ask about that. I got the witness' view that he disagreed. He said if a rate of return were given this apportionment was not necessary. That is all he said.

MR. FRAWLEY: You are certainly going out of your way to attack Mr. Morrison on something he did not say.

MR. EVANS: I haven't attacked Mr. Morrison.

MR. FRAWLEY: Mr. Thompson disagreed with him.

MR. EVANS: He did not disagree with him.

MR. FRAWLEY: He did not disagree with him when it is all explained.



MR. EVANS: May I go on?

MR. FRAWLEY: Yes, but please don't take anything for granted in my free argument with the Commission.

MR. EVANS: I am taking nothing for granted except that I know you will be arguing something.

Q. I would like to turn to another subject, Mr. Thompson. On page 19 of part 2 of the submission of the Canadian Pacific reference was made, Mr. Thompson, to page 4, chapter 7 --that would be the mimeographed brief of Manitoba.

THE CHAIRMAN: Yes, I have it.

MR. EVANS: Q. -- to the suggestion contained in that brief, that the users of the railway service require protection against high interest rates, and the Canadian Pacific points out at this page that while agreeing in principle that protection is needed against high interest rates it points out <sup>as</sup> one way to remove public distrust of the railway companies' ability to earn an adequate return on their investment. I would like to have your views on that question, as related to high interest rates?

A. Yes. I have had considerable experience in taking part in negotiations and discussions in connection with the financing of public companies, and the preparation of prospectuses curving issues of securities to the public, although I do not hold out myself as an expert in railway financing. To my mind/<sup>a</sup>favourable interest rate is predicated upon certain factors: One: demonstrated earning capacity, or what is usually termed "interest coverage"; and that is in most cases measured by a statement showing



the amount available for the payment of interest, a statement covering the period of ten years. And in that connection emphasis is placed on the steadiness of earnings. Public confidence in a company is built up if a company can show that it has earned, and in all probability will continue to earn annually a satisfactory coverage for the interest requirements. The further factor is the nature of the property pledged.

Q. How does that affect interest rate, the question of public confidence?

A. If the public has confidence in a company it is willing to buy its securities because it figures that from year to year, and over a period of years, it will receive a reasonable rate of interest on its investment and the protection of the principal which it has invested.

Q. Now I wish to go on to another subject, which has to do with the segregation of funds as between the funds contributed by the owners and those contributed by the users. In that connection have you read the brief of Manitoba on that subject?

A. Yes I have.

Q. Did you hear Mr. Moffat's evidence on that subject?

A. Yes.

Q. What have you to say about the proposal made by Manitoba, that moneys contributed by the users of the service through deprecation should be segregated?

A. In the first instance, depreciation is just one element of the cost of providing railway services; and I cannot see that any useful purpose would be served by providing any further segregation than is now given in the company accounts. The amount of





depreciation is reflected in the depreciation reserve shown in the company's balance sheet.

Q. When would you say <sup>that a company</sup> had recovered its depreciation charges from the users of the railway?

A. I would say that it recovered its depreciation charges from the users of the railway when revenues are <sup>as</sup> such/to provide for all operating expenses, including depreciation, as well as requirements for fixed charges, dividends and a reasonable surplus. Only then, and not until then, in my opinion, will the railway have recovered its depreciation.

Q. Now there are certain submissions, and I am not going to detail them to you on that subject, in Part 2 of the Canadian Pacific brief. Have you any views to express about the submissions in the brief on the subject?

A. Yes. I am in full agreement with the views expressed on page 22 of Part 2 of the Canadian Pacific submission.

Q. Where that subject is dealt with?

A. Yes.

MR. EVANS: Your lordship will see a paragraph that stands out a little beyond half way down page 22 in Part 2.

Q. Having expressed your views on that subject of when it could be recovered, assuming that railway requirements for operating expenses, depreciation, fixed charges, dividends, and <sup>a</sup>/reasonable surplus are met out of rail revenues, what, then, is your opinion as to whether the funds provided through depreciation should be segregated, as Manitoba proposes?

A. My view is, I don't think the amount so provided should be segregated in any other manner than they



are now reflected in the railway accounts, that is in the depreciation reserve account.

Q. Why do you say that?

A. Because I believe, and it is my opinion that in order to determine a rate base the amount of depreciation reserve would ordinarily be deducted from the gross investment in the railway property, and if the amount of that depreciation reserve is known it is not necessary to segregate the funds which have been created by setting aside a reserve.

Q. What you say is that all of the depreciation recovered from the users, comes off the investment base for the purpose of return?

A. That is correct, yes.

Q. Now then, on the matter of depreciation there is no further question in connection with reserves. At pages 81 and 82 of the printed brief of Manitoba suggestions are made that unless there is segregation such as the province proposes, the users of the railway service will not derive full credit for that part of the company's money contributed by them, through charges to expenses for depreciation. Do you consider that there are at present any safeguards against the undue accumulation of depreciation reserves?

A. Yes. Any excess depreciation it may have set aside will be reflected in the depreciation reserve, and when the amount of that reserve is deducted from the investment, to arrive at the depreciated investment, the rate base thus determined upon which the rate of return is predicated, will be that much lower.

Q. Now, are there any other safeguards, in your view?



A. Yes. I think if the amounts set aside appear too high, then the Board of Transport Commissioners has power to intervene; and that can be done by a study or studies made by the Board, or its experts, to determine whether or not the depreciation rates are reasonable, and measure the amount of depreciation which should be set aside in respect of railway investment.

Q. Now, I am going to take you to another subject, the rate of return on depreciated assets.

THE CHAIRMAN: We will take a recess.

---Recess.

(Page 17484 follows)





---(Upon resuming):

MR SHEPARD: Mr. Chairman, I understand from my friend Mr. Evans that he is about to leave the section in Part II of the C.P.R. submission dealing with references to Manitoba's submissions on both the financial condition of the company and depreciation. I think perhaps it might save time in cross-examination if I just made a short statement as to my understanding of Manitoba's submission. That is that it is predicated on the assumption that rate cases are based upon C.P.R. requirements. My understanding further is that if instead of requirements the rate cases were predicated upon rate base and rate of return, Manitoba in all probability would not differ from the evidence given by Mr. Thompson.

THE CHAIRMAN: We will see how that works out.

MR EVANS: Q. Then, Mr. Thompson, I would like to direct your attention to the transcript at page 8983, where the following question put to Mr. Moffat and his answer appear:

"Q. But surely you are advocating something in the nature of a principle. Now, you must have some view. Would your view be that a lower rate of return would be available on the whole property of the Canadian Pacific because through the processes of depreciation all of its depreciable assets had been replaced?

A. I think probably yes. I have not specifically discussed it among our group and I do not propose to set myself up as an expert on that particular point but I would think the answer is probably yes."

Would you give the Commission your views on that matter?

A. In my view, if the original assets had been replaced through funds provided through depreciation, the new



assets are entitled to the same rate of return as the original assets.

Q. Would you please say why you have that view?

A. Yes. I might give it by way of an illustration. Let us assume that the original investment was \$1 million in railway property. That investment is from shareholders' money. It is entitled to a reasonable rate of return, and as those assets are worn out and replaced by new assets the shareholders' investment remains undisturbed, so that in the end result the original assets disappear and the new assets replace them, and the original position is the same at the end, that the shareholders have subscribed \$1 million, it is still there, the depreciation which has been accumulated has written off that investment, the new investment of \$1 million is there, and it is entitled to the same rate of return.

Q. Now, is there a distinction in principle between the use and replacement of consumable supplies provided originally out of shareholders' money, and the use and replacement of fixed assets, in your view?

A. No, I do not think there is any distinction in principle, except that in the case of the fixed assets the process takes a little longer.

Q. Now, still another subject: Mr. Thompson, you have heard in these proceedings -- and you have perhaps heard it more in the Board of Transport Commissioners' proceedings -- views expressed by witnesses for the provinces, and indeed by provincial counsel, that the earnings from certain non-rail investments of Canadian Pacific should be included in rail earnings; you have heard that evidence?

A. Yes.

Q. And that argument. Are you familiar with the balance sheet of the Canadian Pacific and the financial



statements of the company, which divide the earnings as between rail and non-rail operations?

A. Yes.

Q. What do you say as an accountant as to whether revenues and expenses arising from non-rail activities should be included in rail operating income or expenses?

A. In my view, statements showing the financial results of railway operations should not include extraneous revenues arising from non-rail operations.

Q. Why do you say that?

A. Because the end result would be neither rail nor non-rail, but a combination of both, and in my view quite confusing.

Q. Assuming that it should be decided that non-rail assets are to be included in rail investment, what do you say as to whether the additional investment represented by the assets that are earning that non-rail income should be allowed to earn a fair return?

A. Well, if that is the case, then that additional investment should be permitted to earn a reasonable rate of return.

Q. If you took that into the rail investment and it should prove that the non-rail activities, instead of being profitable, were unprofitable, and actually incurred losses, what then in your opinion would be the result of taking these in?

A. In my opinion, if the investment in non-rail activities was taken into the rail investment, you should provide a fair return on that additional investment, whether the non-rail activities produced a profit or a loss.

Q. Does that mean that you are saying that if the investment in non-rail activities is taken into the rail investment, the rail operations might have to provide some





return for the non-rail investment?

A. Yes, that is the inevitable result of mixing the two, rail and non-rail.

Q. Now, what in your opinion should be the governing factor as to whether items should be classified as rail or non-rail?

A. The governing factor, in my opinion, is whether or not the asset is producing or furnishing transportation service. In that case it should go into rail.

Q. Now, I do not want to take you through the various ones, but how would you apply that test to express activities, for example?

A. In my view, the Canadian Pacific in reporting as rail income the net revenue from express services and excluding any revenue from financial services of the express company, is following the correct procedure.

Q. Yes?

A. As a result of this procedure the railway operating revenues and expenses are correctly reported, and no confusion arises in determining net railway operating income.

Q. Now, how about the Canadian Pacific Telegraphs, the commercial telegraphs?

A. I have the same view there, that the rail activity should only be charged with the cost of furnishing communication services to the railway.

Q. Thank you, Mr. Thompson.

THE CHAIRMAN: Any questions?

CROSS-EXAMINED BY MR SHEPARD:

Q. Mr. Thompson, I suppose you would agree that the function or one of the functions of the Board of Transport Commissioners is to protect the public interest; that is



the reason it was set up in the first place?

A. Yes, I would not disagree with that statement.

Q. And its functions to do that are particularly with reference to insuring that a certain minimum standard of safety is observed by the railways, and also fixing just and reasonable rates?

A. Well, as to standards of safety, I don't know that I am qualified to express an opinion. As to rates, I think, yes, that they are there to see that just and reasonable rates are charged by the railways.

Q. And that of course would have the connotation that we have heard about a good deal, that they must be just and reasonable not only to the carriers but to the freight-paying public?

A. Yes, that is correct.

Q. Would you think, with that broad concept in mind, that it would be desirable for rate-making purposes that there be uniformity of accounting among rail carriers in this country?

A. Yes, I would subscribe to uniform accounting. I think that there are minor differences which exist, and in prescribing any system of uniformity I do not think that the rules laid down should be too rigid. I think some latitude should be allowed shall we say to the carriers.

Q. Don't you really have to substitute some other word for uniformity, under the conditions you envisage?

A. No, I do not think so, because I think possibly you can achieve ninety-nine per cent uniformity, and that when you come to a question of determining rates or rate case, you could take into account the differences which exist shall we say between the several reporting railways -- differences, if any.

Q. What would your views be, Mr. Thompson, about the



desirability of having uniformity of depreciation practice among all the carriers?

A. I think it would be desirable if it could be achieved.

Q. And do you see any reason why it could not be achieved?

A. Well, I think I have been associated with this case long enough that there seems to be a difference of opinion as to which method of depreciation should be followed.

Q. Aside from the necessity of resolving an existing difference of opinion, there is no reason why there should not be uniformity?

A. Well, on that my view is this, that, assuming that one railway uses the straight line method and the other the user method, the two methods can be reconciled for rate-making purposes, and I do not think it should be necessary to tie the hands of any railway which has in mind or wishes to adopt the user method.

Q. In other words, for its own corporate purposes you would suggest that there be freedom among the carriers to select whatever method of depreciation they wish, but you would have no objection for rate-making purposes to having one method or another prescribed for all carriers?

A. I think that is a fair summary of my views.

Q. I suppose you would agree, Mr. Thompson, from your knowledge of the railway accounts, and their expenses particularly, that maintenance expenses constitute a substantial portion of the total?

A. Oh, yes.

Q. And would you consider, again bearing in mind the broad concept of the duty of the Board, protecting the





public interest, that it would be proper for the Board to investigate maintenance expenses?

A. Yes, I think I can agree with that. When you say investigate, that is about the only word on which I might differ with you. If you say to examine railway expenses, I would subscribe to that.

Q. What I have in mind is what you are fully familiar with, namely, the rate cases, where the provinces by cross-examination and by argument attempted to show that perhaps the maintenance expenses were unduly high in a rate-making year. Now, what I wanted to ask you was whether you would agree, first of all that it is possible, however unlikely it may be that it is possible, that maintenance expenses could be loaded, if we might use that term, in a rate-making year, with the result that a greater deficiency would show?

A. Well, I think it would be difficult to load them in any particular year, having in mind a rate case coming up, and what year would you select?

Q. I agree it is very difficult, but would you agree that it is possible?

A. I think it is highly improbable, because a railway must function with a reasonable degree of efficiency at all times, and the question of maintenance is primarily a question of management, having regard to the factor you already mentioned, the safety factor.

THE CHAIRMAN: Q. I beg your pardon?

A. I say the question of maintenance is largely a question of management, and any management must at all times have in the back of its mind the safety factor and the necessity of spending money in order to maintain the road to a reasonable degree of efficiency.

MR SHEPARD: Q. Assuming that it is even a highly



improbable possibility, Mr. Thompson, that these maintenance expenses might be a little too heavy in a rate-making year, or perhaps a lot too heavy, would you consider that it was a proper function of the regulatory tribunal, having in mind its duty to protect the public interest, to closely examine these expenses in order to insure to itself and to the public that they are assisting, that there is nothing of an improper nature included in those maintenance expenses -- and by improper nature I mean either something that might have been charged properly to capital or something that is in the nature of a non-normal expense in the year under consideration?

A. Under those conditions I think the Board would certainly and probably should have the power, if it has not already got it, to analyze and review the statements of operating expenses, and following that I would suggest that they call before them responsible officers to justify the expenses which are made.

Q. Responsible officers of the---

A. Of the company.

Q. Of the company. And I suppose you would agree that as well they should have staff themselves to make an independent investigation if they considered it necessary?

A. To the extent deemed necessary.

COMMISSIONER INNIS: Are you talking now only about the C.P.R., Mr. Shepard?

MR SHEPARD: No, I think my question would be general, for all carriers, sir.

COMMISSIONER INNIS: Because I was wondering whether you had in mind the necessity of some sort of uniform policy as regards maintenance, particularly as it affects labour.

MR SHEPARD: The only point in the line I am following now with Mr. Thompson was to get his views on the



desirability or otherwise of having a mandatory duty cast upon the Board in the Railway Act to engage actively in an examination, more or less constant in character, of the level of maintenance expenditures of the carriers.

COMMISSIONER INNIS: You are not concerned about labour or any other thing?

MR SHEPARD: Not at the moment, sir.

MR EVANS: I hope I am not interrupting, but I am sure you did not mean to make a difference, because in your question to Dr. Innis you suggested that the question had been whether there should be something mandatory in the Act.

MR SHEPARD: I have not got to that question yet.

MR EVANS: All the witness says is that the Board should have power, and of course the Board does have power, and has exercised it.

MR SHEPARD: I am coming to that point now. I have gone a little farther in answering Dr. Innis than I had with the witness.

Q. Mr. Thompson, you have agreed with me, I think, that it would be desirable for the Board to have power to do that, to investigate as actively as they consider necessary to protect the public interest, the level of maintenance expenses. Now, my next question was to find out your view as to whether the public interest is being served adequately in this regard if the Board simply has the power but has not got a mandatory duty to do this?

A. If it has the power but has not the mandatory duty?

Q. Yes; in other words, there is a permissive clause in the Railway Act, a permissive section, saying that the Board may investigate maintenance expenses?

A. Well, that to my mind is largely a question of whether or not the Board satisfies itself or is satisfied





with the reports which come before it and whether or not it deems it necessary shall we say in each and every year to examine and investigate in detail railway accounts. I think that is a matter which in my view I would leave to the judgment of the Board, without directing them to do it by shall we say specific legislation.

Q. That would be your view, notwithstanding the fact that the function of the Railway Act, at least part of its function, is to insure that the public interest is protected?

A. Well, I think surely that is in the minds of the Board at all times. That is why the Board has been created.

Q. That is correct. And you would be satisfied to leave it up to the Board, and if they did not think it was necessary that would be all right with you as a member of the public?

A. Yes, I think it should be left to the discretion of the Board.

THE CHAIRMAN: Mr. Shepard, you have in mind, have you not, that part of the Railway Act which is headed "General Jurisdiction and Powers of the Board"?

MR SHEPARD: Well, I have not any particular section in mind at the moment, sir.

THE CHAIRMAN: Sections 32 and 33 and so on.

MR SHEPARD: Yes, it is in that.

THE CHAIRMAN: It says what the Board shall do.

MR SHEPARD: Yes, sir.

THE CHAIRMAN: Are you saying now inferentially that there should be introduced into that part of the Act an obligation on the Board to do certain things?

MR SHEPARD: Yes.

THE CHAIRMAN: Now, they have power to do it.



MR SHEPARD: That is right, Mr. Chairman.

THE CHAIRMAN: But it should be compellable to do it.

MR SHEPARD: Yes. To be quite frank, Mr. Chairman, I am not in a position at the moment to say whether Manitoba will be putting in an amendment to that effect or not, but we are giving it consideration, as to whether the Board is now sufficiently seized of the matter by simply having the power, or whether it would be preferable in the public interest to have a mandatory obligation placed upon the Board to actively take steps to insure that maintenance expenses are not at an improper level for rate-making purposes.

THE CHAIRMAN: In that case, then, you would have to have a special proviso, a special section, about maintenance expenses.

MR SHEPARD: Yes, sir.

THE CHAIRMAN: That it shall be the duty of the Board to supervise them and so on.

MR SHEPARD: Yes, sir; and it might well be that other expenses would be included in a similar category.

THE CHAIRMAN: And you say that you are still considering whether or not you will suggest an amendment to that effect.

MR SHEPARD: Yes, sir.

THE CHAIRMAN: All right.

MR SHEPARD: Q. Mr. Thompson, the next question I wanted to ask you was -- possibly you might prefer not to answer, but I will put it to you anyway. You have observed the Board of Transport Commissioners in action over the last three years, and I wondered whether you had any views as to what qualifications the members of the Board



should have?

MR EVANS: He is only an accountant, after all.

MR SHEPARD: I have given him lots of leeway to say---

THE CHAIRMAN: What is your question? Would you repeat it, please?

MR EVANS: I said he was only an accountant, after all.

THE CHAIRMAN: I want to make sure that I understand Mr. Shepard's question. What was it you asked?

MR SHEPARD: My question was whether he would care to express any views as to the qualifications that members of the Board of Transport Commissioners should possess.

THE CHAIRMAN: You are talking now in the abstract?

MR SHEPARD: Yes, sir.

MR O'DONNELL: Age, weight, colour of hair, and things like that.

THE CHAIRMAN: Mr. Shepard, the Act says what qualifications they shall have, does it not? -- at least in the case of some of them. They can only hold office until they are seventy-five, and the Chairmen must have certain legal qualifications, and the Assistant Chairman, and so on. What have you in mind when you say---

MR SHEPARD: Well, Mr. Chairman, this witness has had some very impressive qualifications read into the record this afternoon, and he has had wide experience with utility tribunals elsewhere, and I thought that he might have some views which would be of interest to this Commission as to the make-up of a board such as the Board of Transport Commissioners. He might have some suggestions as to how it could be improved, or he might tell us that he thinks it is a hundred per cent the way it is now.





THE CHAIRMAN: Well, when you talk of how it may be improved and whether it is all right now, you are not in the abstract; you are getting pretty concrete.

MR SHEPARD: Well, I will leave it to him, sir, to answer it in the abstract or the concrete, as he sees fit, but I do not want to embarrass him.

THE WITNESS: Well, I think I would prefer not to answer the question.

MR SHEPARD: Well, that is fine.

MR FRAWLEY: I never saw you so shy before.

(Page 17498 follows)



MR. SHEPARD: Q. Now, Mr. Thompson, you are fully familiar, I take it, with the I.C.C. classification of accounts?

A. I would not say fully familiar with them.

Q. But you are familiar with them?

A. Reasonably familiar, yes.

Q. And I suppose you would agree that in applying that classification, or in fact in applying any classification, there is bound to be some discretion left to the carrier as to what account a particular item is charged to from time to time?

A. Well, I think the accounting officers naturally when charging an item to any particular account, would say: "Well, how does this fit into the classification", and it is a matter, I suppose, of the then current thought or view of the accounting officer, how he makes the charge and in what particular category.

Q. Yes, so that if you adopt a uniform classification of accounts and apply it to all carriers, it is possible it would not be applied uniformly by all accounting officers of all carriers?

A. Quite possible.

Q. And would you consider that if uniform accounting is prescribed by the Board, that the Board of Transport Commissioners should therefore police the application of the classification?

A. That would mean, as I see it, a detailed examination of every voucher and document which went through the railway accounts, to determine whether or not the accounting officer had made the correct distribution. It would be a work of tremendous magnitude and would not justify the expense.



Q. It would be a work of tremendous magnitude if the administrative tribunal checked everything?

A. Yes.

Q. But my question was perhaps not properly put. What I had in mind was, would you agree that the Board should have the power, if it so desires, to check into the accounts to satisfy itself, whether by spot check or some other way, that the carriers are in fact applying a more or less uniform interpretation of the classification?

A. Yes, I would agree with that.

Q. Now, Mr. Thompson, I don't want to go through the evidence you gave in the previous rate cases. I think you agreed at that time that the propriety of the charge for depreciation was entirely dependant on the propriety of the rate struck?

A. Yes, I think I said, if the rate is correct then I think in my view the user basis is preferable to the straight line.

Q. And I think you also said at that time that you had not yourself investigated the propriety of the rate struck by the C.P.R.?

A. That is correct.

COMMISSIONER ANGUS: Can you tell us, Mr. Thompson, if a rate were not accurate, would that show up in practice and permit of its correction?

A. Yes, I think so, because whether you use straight line depreciation or user, both should be tested periodically, and if as the result of these tests the rate appeared to be out of line, either too high or too low, then in my view it should be adjusted and that should be done periodically.

MR. SHEPARD: Q. And I presume from what you have





already said that you would agree that the depreciation rates should be either fixed or approved by the Board of Transport Commissioners or the regulatory tribunal.

A. I would go so far with you, I think a "approve". I don't think they should fix them in the first instance. I think that the carrier should apply, shall we say, to the Board, for approval of the rates he thinks he should receive in line with the investment.

Q. But the word "approval" would necessarily carry with it the implication that the Board would be able to disapprove of the rate or suggest a change to the rate suggested by the carrier?

A. Yes, it would.

Q. Your view would be that they in the first instance should tell the Board what the proper rate is - -

A. And defend it before the Board.

Q. And defend it before them, but in the final analysis, whether it is approval or fixing of the rate, it has really to be fixed by the regulatory tribunal?

A. Well, I say, "or approved", of course.

Q. Or approved, and I understand from your experience before other utility tribunals that you would say that that is common practice?

A. Yes.

Q. That the regulatory tribunal normally have to do just that?

A. Approve the rate.

Q. Approve the rate?

A. Yes.

Q. And that necessarily carries with it the responsibility of determining the method?



A. Well, examination of the method.

Q. And actually determining the method. You cannot fix a rate without at the same time saying what method it is going to be applied to.

A. You mean, whether it is user or straight line?

Q. Yes.

A. Well, approval of the rate would, shall we say, approve the method as well.

Q. Yes, that is what I mean.

A. It would carry that with it.

Q. So it is normal for regulatory tribunals to do just that in the approving of a rate. They fix a rate of so much percent for so many years?

A. Or it may be a composite rate.

Q. It may be a composite rate, several types of depreciating accounting. The approving of the rate necessarily carries with it the responsibility by the regulatory tribunal of fixing the method of depreciation accounting to be followed by the carrier or the utility?

A. The only word I quarrel with . there is "fixing" the method. I would say approving the method.

Q. Approving the method?

A. Yes.

Q. But again that word implies the power to disapprove it .

A. Yes, quite definitely.

Q. Now, Mr. Thompson, would you agree that maintenance and depreciation go hand in hand at least to the extent that service life is extended by proper maintenance?

A. Well, I would say this, that in determining the depreciation rate is is usually assumed there will be proper maintenance.



Q. Yes.

A. Now, when you say the life will be extended, if you have an asset which, say, has a lifetime of thirty years, I think you must assume that during those thirty years there will be reasonable maintenance, and any rates of depreciation which you set are predicated upon that assumption.

Q. Yes, and reasonable maintenance (which is your phrase) would, I take it, mean that in periods of higher use you would have higher maintenance expenses. Otherwise it would not be reasonable maintenance?

A. You might have.

Q. Yes. Well then, would you agree with this, Mr. Thompson, that in a period of higher use of an asset or group of assets, the physical depreciation presumably would be higher, the physical depreciation through use would be higher; but that if during that same period you have higher maintenance expenses, you would largely overcome that higher use through the extra maintenance expenses?

A. I don't think that would necessarily follow.

Q. Why would it not follow?

A. Well, in periods of, we will say, intensive use, you would be obliged, shall we say, to spend probably a large amount of money for maintenance; but that money would be properly chargeable against the operations of the particular year where you had that high use, because the, shall we say, equipment or the investment in railway property was being used up more rapidly in that particular period than it would be in a depression period for example. So I think obviously where you have a high traffic volume,





your expenses will be up. Conversely with low traffic volume your expenses will be down.

Q. Yes, but if the use factor can be largely overcome, the use factor in physical depreciation can be largely overcome by current maintenance, the attraction for the user basis of depreciation is not so great.

A. Well, I don't think that it can, of course. I think that the use factor is not overcome by current maintenance.

Q. Now, you recall your cross-examination by my friend Mr. MacPherson in the 21 Per cent Case?

A. I don't recall all of it.

Q. Do you recall the cross-examination dealing with the maintenance of a box car?

A. Oh, very vividly, yes.

Q. And I think it was demonstrated there that a box car can be replaced to all intents and purposes and its service life extended almost indefinitely, through current maintenance?

A. Yes, of course, ultimately, no matter how you maintain it, it will fall to pieces.

Q. Yes, but that is presumably at the end of a period of years through obsolescence or action of the elements on the unit?

A. Yes, in part.

Q. In the main.

A. For instance, take any piece of equipment. You can keep on replacing the parts and doing your best to extend its lifetime to get as much use out of it as you can, but there comes a day when that equipment, no matter what you do to it, won't run any longer.

Q. I quite agree.



COMMISSIONER ANGUS: Would you distinguish between two things, higher maintenance in years of greater use, and excessive maintenance designed to overlap with depreciation? Are those different concepts?

A. Higher maintenance in years of - -

Q. Of higher use.

A. Of higher use, and excessive maintenance - -

Q. Replacing a box car, so to speak.

A. Well, take excessive maintenance. I think possibly that might come about if monies were spent in excess, shall we say, of what normally should be spent, instead of scrapping the unit which it might be more economical to do in the long run.

COMMISSIONER ANGUS: I think it is time to adjourn.

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---The Commission adjourned at 4.45 p.m., to meet again at 10.30 a.m. on Thursday, March 9, 1950.

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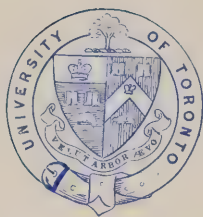
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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO  
THURSDAY  
MARCH 9, 1950

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN  
HAROLD ADAMS INNIS - COMMISSIONER  
HENRY FORBES ANGUS - COMMISSIONER

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G.R. Hunter  
Secretary

P.L. Belcourt  
Asst. Secretary  
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G.C. Desmarais, K.C.		
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H.C. Friel, K.C.		
F.C.S. Evans, K.C.	}	Canadian Pacific Railway
I.D. Sinclair		
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Wilson McLean, K.C.		
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J.J. Frawley, K.C.	)	Province of Alberta
F.D. Smith, K.C.	)	Province of Nova Scotia; Transportation Commission of the Maritime Board of Trade
J. Paul Barry	)	Province of New Brunswick
C.W. Brazier	)	Province of British Columbia
F.R. Hume	}	Canadian Automotive Transportation Association
M.L. Rapoport		

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Ottawa, Ontario  
Thursday, March 9, 1950.

M O R N I N G      S E S S I O N

--- The Commission resumed at 10.30 a.m.

JAMES C. THOMPSON, RECALLED

CROSS-EXAMINATION BY MR. SHEPARD (Cont'd):

Q. I only have a few more questions to ask you, Mr. Thompson.

A. Mr. Shepard, before you begin I would like to explain a little further an answer I gave to one of your questions yesterday so that there will be no misunderstanding as to my answer. I feel that my answer did not go far enough to give full expression to my views. I should like you to refer to the transcript at page 17489 when you were discussing the question of depreciation. About half-way down the page you put the following question:

"Q. Aside from the necessity of resolving an existing difference of opinion, there is no reason why there should not be uniformity?"

My answer was:

"A. Well, on that my view is this, that, assuming that one railway uses the straight line method and the other the user method, the two methods can be reconciled for ratemaking purposes, and I do not think it should be necessary to tie the hands of any railway which has in mind or wishes to adopt the user method".

Then your further question was:

"Q. In other words, for its own corporate purposes you would suggest that there be freedom among the carriers to select whatever method of depreciation they wish, but you would have no objection for ratemaking purposes to having one





"method or another prescribed for all carriers?"

My answer was:

"A. I think that is a fair summary of my views."

Now, I should like it to be understood that my preference is for the user method both for ratemaking purposes and for corporate purposes. I think I made myself quite clear on that point in the 30% case, and I should like to refer you there to my evidence in volume 777, at page 14345. I said this:

"There should be no question of having one basis of depreciation for corporate purposes and another basis of depreciation for ratemaking purposes. My opinion is that the user basis is sound for both corporate purposes and for ratemaking purposes."

I should like to say that is still my opinion, and I thought it better to clear the point at this time so that there would be no misunderstanding between us.

Q. I think I understood, Mr. Thompson, that you would favour user either for ratemaking or for corporate purposes but the concept that I had in mind when I asked that question yesterday was that having obtained your agreement - or I think I obtained your agreement-that the depreciation rate should be approved by the regulatory tribunal, having gone with you that far or you having gone with me that far, it is conceivable that the regulatory tribunal might fix a rate other than user, or use a method other than user, and then I wanted to get your views as to whether, if that were done, it would present an insurmountable problem so far as the railways were concerned?

A. I think if that were done the railways would be obliged to follow the direction of the Board of Transport Commissioners; in other words, it would be a mandatory



direction, but I feel this, that having in mind user it would still be open to them to say, "We will follow this but we think we should get something in addition to it to recognize use."

Q. For corporate purposes?

A. For ratemaking purposes.

Q. For ratemaking purposes as well?

A. Yes.

Q. That is fine. I only have two or three more questions on depreciation, Mr. Thompson. I wondered whether you would agree with me that the real test as to whether user may be preferable to straight line is to what extent the life of the assets being depreciated varies with use?

A. Yes, I think that is fair enough.

Q. So if you did have a group of assets that did not vary with use the straight line method would be just as satisfactory as user because there would be actually the same charge each year?

A. Assuming that the wastage was exactly the same in each year it would not make any difference which method was used but I do think this, of course, that wastage varies and therefore the user method is preferable.

Q. I think you said that yesterday too. Again on a hypothetical basis perhaps, would you agree with me that if physical depreciation due to use could be overcome one hundred per cent by maintenance, that then the life of the asset would not vary at all due to use?

A. Of course I cannot subscribe to that because you are posing an impossible question.

Q. But on a hypothetical basis that would be correct?

A. Well, I cannot conceive of such a situation existing.

Q. Even in theory?

A. In theory.



Q. You do recognize of course that the elements of physical depreciation are several in number. Use is not the only one?

A. Oh, I agree with that.

Q. And that it is quite possible for physical depreciation to occur more through obsolescence and action of the elements than through use?

A. No, I cannot subscribe to that because I think it is due to, shall we say, several factors entering into depreciation. Obsolescence is one. Physical deterioration is another -

Q. Wear and tear?

A. Wear and tear, and I think in any depreciation method one must assume that there will be reasonable maintenance so as to ensure that the asset can be used productively during its lifetime.

Q. Switching to another subject, Mr. Thompson, but still on depreciation, Mr. Liddy gave evidence yesterday with respect to marginally used equipment or marginally used assets, and expressed the opinion - I think perhaps you were in the court room --

A. Yes, I was here.

Q. Expressed the opinion that because there are certain marginally used assets among those of the C.P.R. that user was preferable for that reason. Depreciation in the C.P.R. is on a group basis?

A. That is correct.

Q. There is no question about that, and that is so whether straight line or user is the method followed?

A. Yes.

Q. And in any group of assets I suppose you would agree with me that certain of those assets would be used a great deal, certain would be used perhaps what we might





call a normal amount, and certain of them would be used on a marginal basis, in other words, not fully used?

A. Use will vary.

Q. Would you not think in a group there would always be a balance between the quantum or amount of use each unit in the group of assets is put to?

A. I think, of course, that depends on traffic volume in the first place. Secondly if certain units within the group are used extensively say at the beginning of their normal life and later the use is less and less as the years roll on until they are scrapped, new assets are coming in and as the old assets are used to a lesser degree the newer assets are used to a greater degree.

Q. That is the point, yes.

A. I think over the period one factor balances the other.

Q. Yes. I think in your direct examination by Mr. Evans yesterday afternoon you made a statement to the effect that you felt that the investing public had lost confidence in C.P.R. common stock?

A. Oh, I don't think I said that.

Q. Didn't you?

A. I discussed simply interest, purely in a theoretical way, what fixes high or low interest rates, not necessarily referring to the C.P.R.

Q. Would you consider the public has lost confidence in railway stocks generally, common stocks?

A. They are quoted at less than par - at least, the C.P.R. is.

Q. Have you any views at to why the public has changed its views?

A. I can give a personal view on that. I incline to this view, that the C.P.R. did not pay dividends for a



certain number of years, and for that reason the public thought their money could be better employed elsewhere.

Q. What I was really more interested in than that was whether you had any views as to why the C.P.R. was unable to pay dividends?

A. Definitely because its earnings were insufficient to do so.

Q. And the adverse earning position it found itself in would be due in large measure to the development of competing forms of transportation in your opinion?

A. That is out of my field, I think.

Q. You would prefer not to answer that?

A. Yes.

Q. I think that is all. Thank you, Mr. Thompson.

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(Page 17511 follows)



CROSS-EXAMINATION BY MR. FRAWLEY:-

Q. Mr. Thompson, I would like to talk to you first about something you said yesterday to Mr. Evans at page 17485. Mr. Evans was asking you to comment on something Mr. Moffat had said at page 8983. Mr. Moffat had expressed the view that a lower rate of return would be available on the whole property of the Canadian Pacific because through the processes of depreciation all of its depreciable assets had been replaced. I suppose it should be "if and when through the processes of depreciation all of its depreciable assets had been replaced". Now, you were asked to comment upon that, and you offered what is perhaps a contrary view, and I only want to be clear that I understand what you say, Mr. Thompson. You say that when the purchase price of an asset, a box car, has been completely recovered through depreciation charges, a new box car takes its place and then the new box car begins to be depreciated?

A. That is correct.

Q. And quite properly these charges are put into the expenses for the depreciation of the new box car?

A. That is right.

Q. And that is what you are saying really in the top part of 17485?

A. Yes.

Q. Then, Mr. Evans asked you about the fixed assets, and it was that question I wanted to talk a little bit about. Mr. Evans asked was there any distinction between the use and replacement of consumable supplies and fixed assets in this matter of recovery through depreciation, and you said:-

"I don't think there is any distinction in principle, except that in the case of fixed assets the process takes a little longer."





Now, Mr. Thompson, presumably on the Canadian Pacific some assets with respect to which the original cost or purchase price has been recovered - wouldn't you think there were some?

A. Well, I don't know.

Q. I am trying to think of, say, a station building in an old part of the line. There is one that I often think of as being pretty old, at Carberry, Manitoba, for instance. Take Carberry, Manitoba, and just assume with me (it may indeed be the fact), but assume with me the fact that the purchase price or the cost of that station at Carberry has been fully recovered in depreciation charges.

A. I doubt it, because for depreciable road depreciating accounting did not start until January 1, 1940, so you have ten years depreciation there which would be insufficient at the user rates in force during that period to recover the cost of that station.

Q. Do I understand that the freight shipper did not have anything at all to do with paying for the cost of that station all through the years?

A. Maintaining it.

Q. Maintaining it?

A. That is right.

Q. The original cost was borne by whom?

A. Either by the shareholder or borrowed money.

Q. And not by the freight user?

A. Not to my knowledge.

Q. So that in the case of that station then we have not got the money back yet. I mean, that strikes me as being rather odd.

A. I would not say so, just looking at the picture



in a broad way. You have had depreciation accounting for depreciable road for ten years. Now, how is it possible - -

Q. No, I agree with you, if it is only ten years, but let us say it has been there for sixty or seventy years, that station at Carberry; let us say it has been there for seventy-five years. You say that the freight shipper has only been contributing to the cost of that station for ten years?

A. He has contributed to the maintenance and upkeep since it was built, and to the write-off or the proposed write-off at some future date, <sup>but</sup> the amount which has been set aside has been over the last ten years only.

Q. Yes, but before that time he did not contribute at all except to the patching up or keeping of it clean and that sort of thing?

A. I would not think so.

Q. The freight rates did not in any way, directly or indirectly, have anything to do with returning to the Canadian Pacific its cost for the station?

A. Not in my opinion.

Q. Then let us get on. That is somewhat strange to me, but it may be it is quite true. Let us get on a theoretical basis. If you had anywhere in the Canadian Pacific an asset that has been fully depreciated, do you think it is right and fair to continue to charge the expenses with depreciation for that property?

A. With respect to that property, first I think you must take this into account that assets are depreciated on a group basis. Now, a group basis contemplates that depreciation will continue until the whole group has been written off. The lifetime of the units within the group is different. Some have a short life, and some have a



long life. All you can do is periodically to test your rates to ascertain the amount of the reserve and say: "Is it fair, is it reasonable?". Then and then only can you form a firm opinion as to whether or not<sup>1</sup>, first, the total depreciation set aside has been a proper amount, and, secondly, whether the rates which are in use are equitable. You must do it on a group basis.

Q. I suppose you don't disagree with the principle - let me put the principle to you first. Would there be something wrong to you about continuing to make depreciation charges in the expenses after the cost had been fully recovered through depreciation charges? That is the broad principle you would agree with?

A. I quite agree to that principle in cases where you are depreciating a unit, one unit.

Q. Take the pipe line between Turner Valley and Calgary, as I know a little bit about it. The life of that pipe line is based upon the life of the Turner Valley field, as you know.

A. Well, I will accept that.

Q. You would assume that. That seems to be reasonable to you to think that is so, I suppose?

A. Of course, the question is, what is the life of the field?

Q. That is right, that is exactly it: what is the life of the field? That is very difficult to estimate, isn't it?

A. Yes.

Q. And generally they are underestimated?

A. You know more about it than I do.

Q. But I do want to test the principle, and I think it is a handy illustration. If the life of the Turner Valley





field is underestimated and the life of the pipe line is estimated to be the life of the field, then after the estimated life has been reached there is . . . plenty of oil still to be brought into the refinery at Calgary, you don't continue to make depreciation charges, do you?

A. No, you have recovered your depreciation, but that is a unit.

Q. Yes, I know, but we go, if we can, from the simple to the complex. What did my friend say about "ridiculous"? I hope, like Mr. Smith, you are not talking to me, Mr. Evans, particularly if you are talking to me about being ridiculous in my cross-examination.

MR. EVANS: I know, I apologize.

MR. FRAWLEY: Please then, let me pursue something.

THE CHAIRMAN: When you talk of estimated life in these cases, are you talking purely of the time?

MR. FRAWLEY: I am talking of the time, yes. Now, Mr. Thompson, you say that is because the pipe line from Turner Valley to Calgary is a unit?

A. Yes.

Q. And you say that is reasonably simple to deal with, a unit of that kind?

A. Yes.

Q. And you say it becomes complex when you get a whole lot of pipe lines; if the Imperial Oil took all its pipe lines in Alberta and put them all into one group, that then it might become very difficult?

A. I think, to deal with on a group basis.

Q. Then would it mean that the pipe line in Turner Valley and the depreciation charges there would be helping to depreciate pipe lines in other areas in the province?



A. It is quite possible, and the converse would apply.

Q. Yes, that might be so, and that is what happens when you group railway assets?

A. That is the whole idea.

Q. Is it done because it is not practicable to do it otherwise?

A. Yes.

Q. Because don't you think it would be a little unfair to the users of the pipe line in Turner Valley to have to suffer charges with respect to depreciation for the pipe line from Leduc to Nisku?

A. I think as a business course, if the business becomes a huge undertaking, you must depart from the unit basis of depreciation to a group basis. That principle has just been recognized by the Dominion Income Tax Department in its new regulation.

Q. That is true. I am thinking of the user of the utility who has to pay for the depreciation in the charges for the freight that he has to carry over the railway.

A. It is something like insurance: you spread the risk.

Q. And one fellow has to pay for the other fellow?

A. And receive the corresponding benefit.

Q. So that we are not able to pursue it any further than that, except that you do agree with the principle that, if it can be ascertained, it is not fair for the freight shipper to be paying in depreciation charges for a station or bridge, or anything else that the Canadian Pacific might own, after the original cost has been fully recovered by depreciation charges?

A. Well, I don't think he does, of course.



Q. That is true, but if he did, that would not be fair; that would be contrary to sound depreciation principles

A. Still, you are putting to me a question, Mr. Frawley, the premises of which I don't think exist.

Q. If they do. You see, I am thinking again about the fact that you have only had depreciation accounting for ten years. If there had been depreciation accounting for stations right from the beginning, from the inception of the Canadian Pacific, what would be the situation now? Is that a fair question to ask you?

A. Yes, I don't mind answering that. The situation now would be that as those stations were replaced they would be written off and new ones built to replace them.

Q. Yes, I want to discuss with you the stations, because there are some that have not been replaced.- it has not been necessary to replace them. It is not a reflection on good management; it just has not been necessary to replace them through all these years. Assume that kind of station, should not that be written out of the investment?

A. No, I don't think so, because there are others which probably have been replaced during that period that could be scrapped.

Q. Of course, that is coming back to the group again?

A. Yes.

Q. Could we just separate them to understand it. If the station at Carberry, Manitoba, had been subject to depreciation accounting all the years from the time it was built, that would be now entirely written off. That seems reasonable - if it was treated singly of course.

A. If it is a single unit; if it was reflected in the books as a single unit, if it had been depreciated for





seventy years and the amount which was set aside was enough to cover the original cost, then you would have an asset which would be fully depreciated. But that is not the case in the C.P.R. accounts because these stations are dealt with on a group basis and not singly.

Q. For two reasons it is not so. They did not begin to depreciate until 1940, so the instance I give you could not arise?

A. That is correct.

Q. But I was putting it to you that there is a situation which would warrant and almost require the writing off of a station that has been standing there and used for seventy years.

A. Well, as against that, I can say this: that there are other stations where the estimated life, shall we say, is fifty-six years which may last only forty years, and in that case there has been under-depreciation, which on the group basis is picked up by, shall we say, over-depreciation of your example.

Q. That is right. In other words, you come back entirely to the group basis; that is what happens in the group basis?

A. Those are the facts.

Q. You take the short with the long? That is the fact once you adopt the group basis?

A. Which obtains in this particular case.

Q. That is right, I am under no misapprehension about that. I just want to discuss the consequences of using the group basis upon assets over the years. One asset is helping the other, to use a loose expression.

A. Yes, in a nice friendly way.



Q. Now, Mr. Thompson, I would like to talk to you just a minute about the Canadian National Railways. I suppose that in all of the questions about whether the Canadian National should be rehabilitated as to its fixed charges and that sort of thing, it all comes down to the question as to whether it is to be used as a yardstick in rate cases?

A. Well, I suppose that would be one of the considerations.

Q. That would really be the only consideration - oh, except perhaps I should say that we have heard an awful lot of talk about the poor morale of the rank and file of the Canadian National.

A. Plus the fact that it has a substantial deficit each year.

Q. Operating deficit.

A. Operating deficit. I mean, after fixed charges.

Q. Of course.

MR. O'DONNELL: Let us be clear about it. There has never been an operating deficit.

THE WITNESS: No, I did not mean that.

MR. O'DONNELL: I just wanted that clear.

MR. FRAWLEY: Q. I said rehabilitation of the Canadian National with respect to fixed charges, but really, as you are now telling me, the only real importance of that is if it is to be used as a yardstick for rate-making purposes.

A. That is one of the factors. I don't know that it is the only one.

Q. What other ones can you think of?



A. I have not given the matter, shall we say, detailed study in any way.

Q. Now, Mr. Thompson, you are, if you will let me say so, a pretty prominent citizen of this country, and you travel in your business from Newfoundland to Victoria?

A. That is correct.

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Q. You have certainly given some thought, like a lot of other people in Canada have, to the affairs of the Canadian National Railways, speaking in a broad sense. Is there any other reason now for talking so much about the Canadian National and the writing down of the fixed charges and so on, except to put it in the position of being used as a yardstick in rate cases?

THE CHAIRMAN: Therefore you mean to say its effect on the Canadian Pacific Railway?

MR. FRAWLEY: Oh, yes.

MR. EVANS: Of course Mr. Thompson is an expert who is called in from outside; he is not an officer of the company; he doesn't speak for the company on anything but accounting matters that concern him. He does not speak for the policy of the company. The brief sets forth the policy of the company. My friend is asking him whether the Canadian Pacific has any other reason for the position it is taking.

MR. FRAWLEY: I certainly am not.

MR. EVANS: I don't wish to interrupt, but --

MR. FRAWLEY: I certainly am not. Where did my friend get the idea that I was talking to him about the Canadian Pacific. I am talking to Mr. J. C. Thompson about --

THE CHAIRMAN: Perhaps I gave it to him. I could not make out what else you had in mind, when you talked about a yardstick, and the apprehension of this company being used as a yardstick. There are only two companies.

MR. FRAWLEY: Yes, my lord. Perhaps I am under some misapprehension when I am asking Mr. Thompson his views about the over-all situation in the Canadian



National Railways. I am not concerned about having him state the position of the Canadian Pacific Railway in that matter.

THE CHAIRMAN: Do you mean his views as an expert accountant?

MR. FRAWLEY: No, I want to get what he knows about the affairs of the Canadian National Railways.

THE CHAIRMAN: As a citizen?

MR. FRAWLEY: As a citizen of Canada.

MR. O'DONNELL: I suppose you are asking him his expert opinion about the profits of the Alberta paper . . .

THE CHAIRMAN: I did not hear that.

MR. FRAWLEY: Q. I put it to you again -- I thought I made it clear -- apart from the matter of using the Canadian National as a yardstick, instead of the Canadian Pacific or, as Mr. Walker said, another yardstick with the Canadian Pacific. . . apart from that - dismissing that from your mind altogether - what is the value and the importance of scaling down the fixed charges of the Canadian National Railways or worrying about the fact that they have these unprofitable roads put upon them?

A. Of course, I have not given that matter any particular study; I have been busy in other ways.

Q. You do not mean to tell me that you just have no idea about that; that you are content to say just that for the purpose of this record?

A. No, I don't think that is fair. I say this, that I follow the affairs of the Canadian National in a rather academic way; I occasionally see their report; I read what is said in parliament and so on, but I have not been specifically interested in the Canadian National affairs. In this case I have given attention to the Canadian



Pacific and their submission; and I have no particular views . . . I haven't given the matter sufficient consideration, shall we say, to decide the full impact of scaling down the fixed charges of the Canadian National Railways, as the submission which it makes contemplates. I haven't studied the matter.

Q. Do you not think it is a good thing for the Canadian National, that is for the morale of the system, to require that it should not be a sort of catch basin for unproductive roads?

A. I think the morale of the Canadian National is quite high.

Q. You would not subscribe to the idea that there is any feeling of not having done a good job of work when they see the terrific deficit which arises after fixed charges?

A. I doubt it very much.

Q. You don't think it is a good thing or a bad thing to put the Newfoundland Railway, with its deficits, on the Canadian National Railway as a system, rather than on the Department of Finance of the Government of Canada?

A. Of course, you have the case of the Hudson Bay Railway which is, of course, in trust. There are two methods which the Newfoundland Railway could be handled on financially; one is to hand it to the C.N.R. and say "You run it as part of the system"; the other is for Canada to take the responsibility, that is, the Government of Canada would follow the method of saying to the Canadian National "You take it and run it --".

Q. Mr. Thompson, you are not going to tell me that is a subject that you have some views on?





A. That I have some views on?

Q. You are not going to tell me that is a subject you have no views on?

A. I had something to do with the negotiations.

Q. You had a good deal to do with the negotiations?

A. Yes.

Q. You were accountant adviser to the Newfoundlanders, were you not?

A. That is correct. It was a matter of complete indifference to the Newfoundlanders how the railway was operated after they had turned it over to Canada.

Q. That doesn't seem to be so now, from what we see in the papers lately. It is still a burning question, isn't it?

A. What I mean is the investment or the continuing investment of the railway, or capital additions and running expenses. That railway, it is well known, ran at a substantial deficit, when you include fixed charges. Now, as far as Newfoundland is concerned, it is exactly the same as the Northern Alberta Railway when that was sold; when the Government of Alberta sold their railway they heaved a sigh of relief and said "We have handed that over."

Q. That is right.

A. And I had something to do with that.

Q. What is the comparison between the Newfoundland Railway and the C.N.R.?

A. The tax payer in the Province of Newfoundland is not now charged with the responsibility of paying for the out-of-pocket expenses, that is the over-all out-of-pocket expenses -- I use that in a general sense -- of running that railway.



Q. And the deficit is now added to the over-all deficit of the Canadian National, after fixed charges, and borne by the taxpayers of Canada?

A. I don't know that for a fact; I assume it.

Q. You know there will be a deficit?

A. I know there will be a deficit.

Q. And there will be a bigger deficit if they are given the complete and full 100 per cent application of the Maritime Freight Rates Act; it will be<sup>a</sup> substantially greater deficit, won't it?

A. Yes.

Q. All I am putting to you, Mr. Thompson, is, don't you think that from the standpoint of the good of the transportation policy of Canada that those matters should be dealt with by the Government of Canada as a government, and not put upon the Canadian National Railways under the guise of a railway operation?

A. Surely I can't decide government policy.

Q. You can express an opinion about it to this Commission.

A. Well, I prefer not to.

Q. You just prefer not to?

A. Yes, sir.

THE CHAIRMAN: I suppose that is a question you might ask of each witness as he comes along, Mr. Frawley?

MR. FRAWLEY: That is true sir.

THE CHAIRMAN: As a matter of a poll of the people.

MR. FRAWLEY: Q. If the Canadian National is not to be made a yardstick with the Canadian Pacific



then those matters I have been discussing with you are largely academic? In such cases, for instance, of whether the Government of Canada should decide whether they ought to have the Canadian National come along with a deficit or operate the railways separately and carry the deficit themselves. I suppose that is a matter that --

A. I suppose over a long period of years some of these ventures may turn out well; they may not. It is hard to say.

THE CHAIRMAN: It seems to me, Mr. Frawley, that it is a matter for argument. You probably intend to argue before us later on that a different policy ought to have been pursued by parliament, and should be recommended to be pursued from now on.

MR. FRAWLEY: I am already on record as saying that I go right along with the Canadian National Railways on that submission.

THE CHAIRMAN: You are quite sure where you are going?

MR. FRAWLEY: Yes; I am going right along with the Canadian National Railways.

THE CHAIRMAN: You mean with what they say in their brief?

MR. FRAWLEY: In their brief, yes.

COMMISSIONER ANGUS: Do they say anything about the Newfoundland Railway?

MR. FRAWLEY: Am I going to say anything about it?

COMMISSIONER ANGUS: No; does the Canadian National in their brief say anything about that policy?

MR. FRAWLEY: I think so. They speak of the





burden of unprofitable lines. I take it that that brief having been filed in October last, that there would be a passage -- my recollection is that they do deal with the Newfoundland Railway.

MR. O'DONNELL: There was mention of it both in the outline submission and in the other.

MR. FRAWLEY: I think the only one was the Temiscouata Railway, because it had not been given to them at that time.

THE CHAIRMAN: The point is this, do you think there is anything to be gained by piling up evidence of what one man thinks and what another man thinks?

MR. FRAWLEY: No, I don't think so, sir.

Q. I do want to ask one question about a suggestion Mr. Walker makes in his statement, at page 14 of the pamphlet that was distributed. I am sorry, but I do not have the page in the record. The paragraph, Mr. Thompson, reads this way:

"The danger of injury to the Canadian Pacific (and it cannot be too strongly emphasized) lies in the suggestion that the Canadian National results might be used as a yardstick on the footing that its requirements should be limited to earning its fixed charges (after these have been substantially reduced) and a small surplus, without any assurance or direction that the system should and must be allowed to earn a fair return on the investment in railway facilities."



Now, I suppose that is the same as you say, that the Canadian National must pay dividends.

A. Not necessarily, I would take that as meaning the Canadian National should earn a reasonable rate of return on its rail property investment, or a reasonable rail property investment.

Q. And that it would fall short of being required to earn such, to pay a reasonable dividend?

A. Of course, when you say dividend . . . the Canadian National is not a corporation as such.

Q. That is true, but I was using the term. You cannot use the term. . . that is being a little technical. Without using the word dividend, they should create a fund which in the case of a private corporation would be a dividend fund.

A. Would be available for dividends or other purposes.

Q. Or as the Canadian Pacific, or Mr. Walker, has in mind, there should be a parity of treatment between the Canadian National and the Canadian Pacific?

A. Yes. As I see the picture with the Canadian National, if it took the railway property investment, and a proper dividend on the transportation services, and apply a reasonable rate of return on that, that is the normal way, I would say, it should be dealt with.

Q. Just putting that in very plain language, it means, does it not, that the Canadian National before it can be used as a yardstick -- the idea Mr. Walker viewed in his submission -- it must be required to -- he says directed and required to . . . I should not use



the word "required", but there must be some assurance or direction that the system should and must be allowed to earn a fair return on its investment. Well, is that not just almost the same thing as saying that it must build up a fund over and above everything else which would be available for dividends, if it were a private enterprise?

A. It would be available for the payment of interest, the payment of fixed charges, or available for a reasonable surplus, and with these matters arranged it may pay a dividend to Canada.

Q. Mr. Thompson, it would not really be satisfactory <sup>if</sup> it did not do that; to be fair to the Canadian Pacific, its earnings must be of that order, that they pay, of course, their fixed charges, their interest on loans, and a surplus, and some dividends, because that is what the Canadian Pacific strives to do and must do, in justice and fairness to its shareholders?

A. Yes, of course, automatically if you had a rate of return set on a reasonable investment in rail property, it should be such that a return would be made or be paid to the equity owners, in this case the Government of Canada.

Q. In other words it should be money of that order earned to enable them, over and above everything else, to have something to pay dividends . . . using the word dividend?

A. Using dividend in rather a loose way.

Q. All right. Mr. Thompson, what strikes me about that is, isn't there a fundamental difficulty that one is public ownership which does not contemplate the payment of dividends, and the other is private





enterprise which does contemplate payment of dividends? Isn't there a fundamental distinction between the two enterprises there?

A. Well, don't forget this that the government of Canada has a large equity in the Canadian National, on which no interest is charged, and it does not receive any return; the money has gone into the system one way or another, rightly or wrongly.

Q. What I am putting to you, Mr. Thompson, is, supposing the Government of Canada said "Well, we certainly want the Canadian National to pay all its operating expense and interest on outstanding loans, and its fixed charges and so on, but that is all; we are not concerned with it earning dividends; the people of Canada do not particularly want the Canadian National to pay dividends. . ." I am putting it to you, suppose that were the attitude of the Government of Canada, that does not correct the difficulty?

A. Of course you are describing a fundamental difference between private ownership and public ownership?

Q. That is right; and that is exactly the question, one is public ownership and the other one is private ownership?

A. That is right.

Q. Don't you think for practical purposes we have to give up any idea of using the Canadian National as a yardstick?

A. Well, I don't think I can answer that question.

Q. Well, it is a simple practical question?

A. No; it is a question which has many implications; I mean you are covering a lot of territory in a question like that.



Q. To put the Canadian National Railway in the position of being a yardstick along with the Canadian Pacific, or in the place of the Canadian Pacific, you would have to go over from the concept of public ownership, and make a sort of pseudo private enterprise for the purpose of return, or something of that sort?

A. I think you would have to do this: you would have to take/<sup>a</sup>reasonable property investment, a reasonable rate of return so as to enable both railways to take care of their requirements for fixed charges, for interest or dividends -- in the case of the C.P.R. -- and for a reasonable surplus.

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THE CHAIRMAN: Surplus in the case of the C.P.R., I suppose, might be used to pay dividends, but in the case of the Canadian National there would be nobody to pay dividends to.

MR FRAWLEY: Except, my lord, that up to now the requirements of the Canadian Pacific have always been so many millions for fixed charges, so many millions for dividends and so many for surplus. It has been separated out, and that is the way I am putting it.

THE CHAIRMAN: If dividends were not paid, would not that amount simply add to the surplus?

MR FRAWLEY: In the case of the Canadian Pacific?

THE CHAIRMAN: Q. Is that what would happen?

A. Yes, that is correct.

COMMISSIONER ANGUS: Q. Mr. Thompson, is there any reason why a government-owned railway should not be expected to pay a return to the Government on its equity in that railway?

A. No, I do not think there is any reason at all, because there are numerous utilities throughout Canada, particularly municipal utilities, which are run at a profit, and that profit is used for the general purposes of the community, to reduce taxes, general property taxes, and if the Canadian National Railways ran at a profit and turned that money over to the Government of Canada, I do not see any reason why it should not do so.

MR FRAWLEY: Q. Then you would put it precisely on the same basis as the Edmonton Telephone System, which makes a big profit, and it goes to reduce the load of the Edmonton taxpayers?

A. That is one illustration.

Q. And the Electric Light System in Edmonton --





precisely that. They charge more than they should, because they do it deliberately, to reduce the load on the taxpayer. That is so, Mr. Thompson; you lived there for many years?

A. Well, not more than they should. The rates do produce revenue.

Q. But they make it produce a profit in ease of the tax burden?

A. Yes. I do not think that is objectionable.

Q. Then you are suggesting that that could be done with the Canadian National Railways and the treasury of Canada?

A. Yes, if the operations of the Canadian National showed a profit, then that profit I think could well be devoted to the general welfare of Canada.

Q. But if it showed a profit, if the objective was that they must show a profit -- that is the difference?

A. I think then, of course, you have to take this into consideration, that in setting freight rates to produce a profit you have to take into consideration the level of those freight rates; I mean, the freight rates which are set will produce a profit.

Q. Then you would certainly soon be getting to the point where you would be asking the freight shippers to ease the income tax burden, say; that would be an objectionable situation, wouldn't it?

A. I think we could do with a little easing of the income tax burden -- not necessarily from the freight shipper, I agree with you.

Q. I am glad you added that -- particularly west of the Great Lakes and east of Montreal.

COMMISSIONER INNIS: Q. Do you think it would be fair for the Canadian National to impose higher rates and to



secure a larger profit from its users in order to benefit the rest of Canada?

A. No, I do not advocate that at all.

Q. That was the inference.

A. I do not advocate that, no.

MR FRAWLEY: Q. You are making it quite clear, you are not advocating that? A. No.

THE CHAIRMAN: What is the ideal, then? -- that it should run at an even rate, to have neither profit on one side nor loss on the other?

MR FRAWLEY: My submission is---

THE CHAIRMAN: If there is a loss, then the rate-payers of Canada must make it up, and if there is a profit the shippers must provide it.

MR FRAWLEY: My submission, my lord, which takes us out of all these difficulties, is that the publicly-owned railway must not be regarded as the yardstick, and the Canadian Pacific must be regarded as the yardstick, because there the earning of a dividend is a legitimate objective, and everybody agrees that it should, and freight rates should provide that. But to have the Government of Canada demanding a dividend from the Canadian National, and having the freight shippers pay into that dividend fund, is, in my respectful submission, contrary to all that my people have---

THE CHAIRMAN: It is always a matter for argument.

COMMISSIONER INNIS: How much dividend are you willing to pay the C.P.R., Mr. Frawley?

MR FRAWLEY: I am willing to pay them a reasonable dividend on the amount invested in railway facilities, no more.

MR O'DONNELL: What rate?



COMMISSIONER INNIS: You do not care to be any more precise?

MR FRAWLEY: No; that is as precise as I can be. We have never yet in our submissions objected to the rates of 4 per cent and 5 per cent, if that is an answer, sir.

MR EVANS: Oh, my, yes! My friend is, with respect, not quite correct. The point about dividends has always been that my friend says that 5 per cent on the common stock of the Canadian Pacific is adequate as a corporate dividend, and should be apportioned between rail. Now, we have said that 5 per cent is a minimum from rail, and when my friend says he has not quarrelled about the amount of the dividend, he does not distinguish between what rail should produce and what Other Income should produce.

MR FRAWLEY: My position is exceedingly simple. I do not quarrel with the decision which the directors of the Canadian Pacific have arrived at, that they should pay 4 and 5 per cent corporate dividend. That is their affair, not mine. I accept that, but I say that must be apportioned, and that, the dividend being a corporate requirement, the Other Income must bear its share.

COMMISSIONER INNIS: 5 per cent is a sort of absolute maximum as far as you are concerned.

MR FRAWLEY: Yes. If they increase it, we might have other views, but at the moment my advisers instruct me that 5 per cent is all right as a corporate dividend.

COMMISSIONER ANGUS: Mr. Frawley, do you think the Government of Canada ought to make it clear in the Railway Act or otherwise exactly what it does expect its railways to earn?

MR FRAWLEY: When you say its railways, you mean---





COMMISSIONER ANGUS: The Canadian National Railways

MR FRAWLEY: Oh, the railways it owns? I cannot disagree with that, unless it is clear enough now by implication. It is a publicly-owned railway, and it is not ordinarily expected to earn a dividend.

COMMISSIONER ANGUS: Let us see how clear it is by implication. Does the doctrine that rates should be just and reasonable to the railways as well as to the shippers have any implication to the Canadian National? Supposing that it were the only railway, would the Board have any guidance from those words "just and reasonable" in fixing rate levels?

MR FRAWLEY: I think so, sir. If the Canadian National were the only railway, I think still they would not be expected to earn a dividend, and the people of Canada would be just that much better off in the freight rates. That is all, sir, I think. The fair and reasonable rate---

THE CHAIRMAN: If the railway could just break even -- you see, there is no reason why the people of Canada should subsidize me to travel at less than it is worth.

MR FRAWLEY: That is right, sir.

THE CHAIRMAN: On the other hand, there is no reason why I should pay more than a reasonable charge to travel, in order to subsidize the people of Canada.

MR FRAWLEY: When you speak of travel, sir, you are not distinguishing---

THE CHAIRMAN: We have passenger service and freight service, and there is no reason why I should be allowed to ship my goods at less than it is worth and have the general body politic pay the difference.

MR FRAWLEY: That is right, sir.



THE CHAIRMAN: Likewise, there is no reason why I should pay more than it is worth in order to subsidize the body politic.

MR FRAWLEY: No; but, sir---

THE CHAIRMAN: Don't you arrive at that, then, that the ideal for a government railway, since we have it, is just to break about even, so that there will be no hardship on the one hand on the shippers and on the other hand on the public?

MR FRAWLEY: Service at cost, sir -- that is my amateur conception of a public utility publicly owned.

THE CHAIRMAN: That is what you are arguing for, is it?

MR FRAWLEY: Yes, except that I am saying that in the present state of affairs we will have to continue to take the Canadian Pacific as the yardstick, and then we must contribute enough to enable them to earn a dividend. I suppose, sir, the only importance of this branch of the matter before your lordship is the question of the yardstick, because I am inclined to agree that everything else is the Government's business. I suppose it is the Government's business whether they want to take these unprofitable roads in, and I for one, and for the Province of Alberta, am not offering any objection to that at all.

COMMISSIONER INNIS: When you say "contribute enough", just what do you mean?

MR FRAWLEY: I beg your pardon, sir?

COMMISSIONER INNIS: At the beginning of your statement you said something about contributing enough to the railway, the Canadian Pacific.

MR FRAWLEY: Yes. Well, we must contribute enough -- the freight rates must be sufficiently high to



enable the Canadian Pacific to earn a dividend; that is right, sir, just to enable it to earn its dividend.

COMMISSIONER ANGUS: Mr. Frawley, coming back to the idea that if the Canadian National were the only railway, you think that rates would be just and reasonable if they enabled it to pay its operating expenses and pay its fixed charges---

MR FRAWLEY: That is right, sir.

COMMISSIONER ANGUS: Is not the level of those fixed charges a sort of historical accident?

MR FRAWLEY: In the case of the Canadian National?

COMMISSIONER ANGUS: Yes.

MR FRAWLEY: I think, sir, that is why they must now have a major operation performed upon them, sir, yes, and get rid of the accident of birth and history that is now encumbering them.

COMMISSIONER ANGUS: Supposing the Canadian Government paid them off, would you then say just and reasonable rates were rates that covered operating expenses?

MR FRAWLEY: I can see the Canadian Pacific's objection that that would perhaps be unfair. That would be Government in business with a vengeance.

COMMISSIONER ANGUS: If it were the only railway.

MR FRAWLEY: If it were the only railway? I am thinking of the public utility owned in the Provinces of Saskatchewan, Manitoba and Alberta, the telephone system; there is no profit required of that system, no dividend to ease the tax burden of the people of those provinces. I think that is a good example. That is service at cost. That is why the people own telephones out there, presumably with the hope that rates may be lower, because there is no dividend to be paid to private enterprise.





COMMISSIONER ANGUS: I have no difficulty in seeing that, if the Government has quite clearly indicated that that is its policy. The indication of the policy of the Government of Canada is its instruction to the Board that rates should be just and reasonable.

MR FRAWLEY: That is right, sir.

COMMISSIONER ANGUS: Can you read into that that the rates should be such as to cover operating expenses and the fixed charges, if any, irrespective of the amount of the fixed charges? They may be more, they may be less, but the rates should cover whatever they happen to be? Do the fixed charges constitute a target, as it were, for the income of the Government-owned railways?

MR FRAWLEY: No, I would not go that far, sir. I am wondering if we should keep in mind that when "just and reasonable" was written into the Railway Act the railways were privately owned -- there was the Grand Trunk, the Canadian Northern and the Grand Trunk Pacific -- and that has never been changed, there has never been a change. The Government of Canada has never got close enough to the meaning of those words "just and reasonable". There has been nothing but this deficit which accompanied the annual report of the Government-owned railways, and I think that is important. "Just and reasonable" when it was written into the Act had in mind, I would think, a dividend, because---

THE CHAIRMAN: What would you write into the Act now?

MR FRAWLEY: To change that, sir?

THE CHAIRMAN: Would you change it?

MR FRAWLEY: No, sir, not on that score, sir; but I do think the situation Dr. Angus has raised might, with respect, become a very real one when the Canadian National



has been rehabilitated in respect of its fixed charges and if it is freed of these unprofitable railways that have no result except to put them into a deficit position.

THE CHAIRMAN: Freed in what way? Who will operate them?

MR FRAWLEY: Well, I should say then, sir, that one way would be by a trustee, as the Hudson's Bay Railway is operated. But I am making no submission as to that; I have no instructions on that at all. I think the only purpose of this discussion---

THE CHAIRMAN: I am hoping you will be able to make some submission when the time comes. That is what we are here for.

MR FRAWLEY: Well, not, sir, if we do not take the Canadian National as a yardstick. Then these discussions become, if I may say so, academic. Now, whether or not in the larger field of the Commission's work they should make some recommendations with respect to the Canadian National, well, as I say, I am willing to go along with what the Canadian National Railways itself says.

Q. Now, Mr. Thompson, I would like to discuss with you the matter of uniformity of accounts. I take it that you are in accord with the views of I think everybody else, that uniformity of accounts is highly desirable?

A. Yes, I agree to that.

Q. You agree with the difficulty which the Assistant Chief Commissioner felt himself faced with when he made the remarks at page 74 of the 30% judgment, in which he very briefly said:

"From a rate making point of view, however, in Canada, to have one of its major railways on one method of depreciation and the other major railway on another, leads to some confusion. It is more than difficult to



make effective comparisons."

You would agree that it is certainly important in rate-making cases to be able to make effective comparisons?

A. I think it is desirable.

Q. Between the Canadian Pacific and the Canadian National?

A. Yes, I think it is desirable.

Q. Even on the assumption that the Canadian Pacific is to be the yardstick, still it is extremely useful and essential that the Board should be able to make effective comparisons?

A. Yes, I would agree to that.

Q. Now, do you agree with this statement, which is taken from the brief prepared by Mr. Morrison for the Province of Alberta, at page 7:

" . . . in the case of railways, the Board of Transport Commissioners, and on occasion the representatives of the rate paying public are required or entitled to know that the financial statements represent the operating results on a uniform basis."

Do you take any exception to that statement?

A. No, I do not take any exception to it.

Q. "The object of stressing the necessity for a uniform classification of accounts is that the financial statements may truly reflect the correct operating conditions and the financial position generally."

Now, you do say that the railways of Canada, at least the railway by whom you have been retained, should be permitted to continue to depreciate on the user method?

A. That is correct.

Q. Now, I suppose, of course, that you are willing to put that matter into the hands of the Board under a general





authority and requirement to set up uniform accounts?

A. Well, I think it is, and it repeats what I said yesterday to Mr. Shepard, that the carriers should be able or should have permission to formulate their own methods, as to whether they wish to follow user or straight line, and then submit their methods to the Board and argue the matter out.

Q. And then with the Board having the last word, of course?

A. I think the Board would have to have the last word.

Q. When you were discussing that, Mr. Thompson, I wondered just exactly what you meant, because, while from a practical standpoint, from the standpoint of expediency, the railways must first submit their proposals and then come before the Board with a proposal, in the end the Board must say which they select?

A. Yes, I think the Board would have to decide.

Q. Then whether you call that approving or fixing I suppose is just a matter of the use of words?

A. I think you have to distinguish. I mean, my thought is this, that you would say to the Board, "Fix the rate, the method." Now, all I say is this: Leave that with the railway, let the railway decide which method it prefers, and then submit its plan to the Board for approval, in other words let it originate with the railway and not the Board.

Q. Well, that is all right; it can originate; that is what I have been agreeing with. Let it originate with the railway, then it comes in to the Board for the Board's approval; right?

A. Yes.

Q. And the Board may completely disapprove, and say, "Now, we have heard everything you have to say, and we



disapprove of that method of depreciation." You would contemplate that in the scope and the authority which you are willing to give the Board?

A. That is quite possible.

Q. In other words, Mr. Morrison puts it this way, on page 2 of his supplementary brief:

" . . . while we have a definite preference towards straight line depreciation, the paramount consideration is that the regulatory body should prescribe the method of depreciation to be followed after having satisfied itself as to the propriety of the rates involved, whether on a straight line or user basis."

You would not quarrel with that, would you?

THE CHAIRMAN: In the first place, who said that?

MR FRAWLEY: This is in the Alberta brief; it is said by Mr. Morrison, sir.

THE CHAIRMAN: Does that intend that there should be just the one method, though, for both companies?

MR FRAWLEY: Oh, yes, indeed, sir, yes indeed.

THE CHAIRMAN: Q. Do you say, Mr. Thompson, that there is room within the general definition of uniform accounting for two methods, one railway to pursue the one and the other railway to pursue the other?

A. Well, I think it would be preferable for both railways to follow the same method, and my own view is that they should follow the user method.

(Page 17547 follows)



MR. FRAWLEY: Q. That is right? Do you agree with Mr. Morrison when he says that while he has a definite preference towards the straight line the paramount consideration is that the regulatory body should prescribe the method? Don't you agree with that?

A. I will agree with it with the same reservation which I have just made, that the method, the application, should originate with the railways. I think that is important.

Q. I do not see the importance in it really that you do, Mr. Thompson, but that is all right. The railways would submit the method. I presume the Canadian National would come in and submit a method of straight line, and the Canadian Pacific would come in and submit a method of user, and then the Board would have to make one uniform or the other?

A. I think they would have to sit down around a table and decide which method should be used.

Q. And in the end it would become a Board order. You can make it as informal and friendly as you like but in the end result there would have to be a Board order?

A. Yes.

THE CHAIRMAN: Do we understand from now on once the Board has ordered as between two methods that would be satisfactory to all concerned? To you, for instance, Mr. Frawley?

MR. FRAWLEY: Yes. The fact is that since the determination of the 30% case, which became the 21% increase in April of 1948, since that time the Canadian Pacific accounts, on whatever basis they have been submitted, have been taken into the Board's calculations for the determination of rate increases on the straight line basis?





THE WITNESS: Well, I think the position is that the Board has adjusted the depreciation which is shown in the accounts and in fact has reduced the amount which is shown in the railway accounts.

MR. FRAWLEY: Q. That has just been a short method rather than translating their whole depreciation charges into straight line charges? That is what that amounts to?

A. I am not so sure because arbitrary sums were taken, \$2 million in each case.

Q. You are wondering just how they could be related to depreciation charges?

A. Yes. I attempted to do that.

Q. With indifferent success?

A. Well, I don't know that it was indifferent success. I think it got very close to it.

Q. Well, whatever quarrel you have, and I would not want to take away from you any of your views in that respect, the fact is now that the the Board of Transport Commissioners right down to the last judgment handed down a few days ago have declared themselves as being in favour of the straight line method?

A. Well, I do not think they did in the first judgment. They did in the second judgment.

THE CHAIRMAN: Q. They did not what?

A. In the first judgment. The second judgment expressed a preference for the straight line method but the first judgment was non-committal.

Q. When you say the second judgment is that the 8% case?

MR. FRAWLEY: The 8% case, first 21% and then 8% and then the other day another 8%.

Q. 41 Then the fact is that the Board -- I should



perhaps add first that there is no departure in the recent judgment of the 1st of March from what they said on the 22nd of September last?

A. Not in that respect.

Q. In that respect. So the situation is that the idea of the straight line is now pretty well established as the method which this Board prefers?

A. I think there, of course, it is still open for argument.

Q. I was just going to add that I did not mean for a moment that you should not place before this Commission your views with respect to user with the feeling that probably the Commission will declare themselves in favour of the user method. I presume that is why we have heard so much from you with respect to the user method of depreciation.

THE CHAIRMAN: What is it that you want Mr. Thompson to tell us now, to tell us what the Board thinks or what the Board has decided?

MR. FRAWLEY: No, I am putting now --

THE CHAIRMAN: The Board's decisions, insofar as the Board may have gone on this question of the method of depreciation, are contained in the judgments of the Board.

MR. FRAWLEY: Yes.

THE CHAIRMAN: I understood you to ask Mr. Thompson if he does not agree that the Board now does consider so and so --

MR. FRAWLEY: Does consider straight line as the preferable method.

THE CHAIRMAN: Why ask him a question like that?

MR. FRAWLEY: Only to make it clear what the Commission is now being asked to do, and they are quite



free to do it. The Commission is now being asked to declare themselves in opposition to what the Board has said. That is all. I do not mean by me. I am quite content it should be either user or straight line.

THE CHAIRMAN: When the time comes you will read to us what the Board has said, and then we will know what their views are. You will argue that they should be encouraged to keep on in the same state of mind, I suppose?

MR. FRAWLEY: No, I don't know that I should even go that far because my position is very clear and it is a simple one. It should be with the Board, and they can change it now back to user if they wish so long as they make it uniform. It must be the same.

THE CHAIRMAN: You say while it is with the Board the Board must make it clear that there is just to be one method pursued by both companies?

MR. FRAWLEY: Precisely; that is the heart of my submission.

THE CHAIRMAN: Then the Canadian Pacific Railway say the railway should be left free to adopt whichever method they wish to?

MR. FRAWLEY: No, I did not take it that the witness says that. He says in the end --

THE CHAIRMAN: I think Mr. Evans has been saying that, have you not, that the railway should be left free to adopt the user method if it wishes?

MR. EVANS: We agree that the Board should have the right to approve the method we use.

THE CHAIRMAN: One of the two.

MR. EVANS: What I suggest to this Commission is one, that there need not be that absolute uniformity --

THE CHAIRMAN: Uniformity of what?

MR. EVANS: Uniformity of accounting carried to





the point where there must be the same method for both railways.

THE CHAIRMAN: I asked Mr. Thompson a while ago if he saw within the general definition of uniform accounting room for two methods of depreciation, one for the Canadian National and one pursued by the Canadian Pacific, and he said it would be preferable to have just one. That is as far as I got with him. I have understood from you all along that you are not opposed to uniform accounting in principle but that insofar as this method of depreciation question is concerned you want the railway to be left free to adopt either the user or the straight line method. Isn't that right?

MR. EVANS: Yes, sir, but I am not saying that the Board should not have the right at the proper stage to consider the method. I say if we recommend uniform accounting there should be freedom in that uniform accounting for two different methods.

THE CHAIRMAN: That is what I am saying.

MR. EVANS: I do not want you to think that I think the railway should be the sole arbiter of our method.

THE CHAIRMAN: Would you go this far then? First we have uniform accounting, and then up comes this question, this incidental question, of what method of depreciation is to be pursued. You say you would prefer freedom of choice?

MR. EVANS: Yes.

THE CHAIRMAN: And if the Board says no, you are to adopt this one method?

MR. EVANS: We will have to subscribe to that.

THE CHAIRMAN: You think the Board should have that power?

MR. EVANS: Oh, I do not think there is any doubt about that.



MR. FRAWLEY: Q. There is one matter I want to pursue with you, Mr. Thompson. Mr. Crump, when he gave evidence on the 14th of December, spoke about the need to bring the common stock of the railway back to par. You were not here at that time?

A. I was not here.

Q. And I asked him this question:

"Q. Yes. Well, I think Mr. Walker used some adjectives during the last two days that perhaps you would not mind using; I do not remember what they were but he indicated that they were far from where they should be, as he thought?"

The reference was to freight rates, and Mr. Crump's answer was:

"A. I quite agree with that, bearing in mind the fact, of course, that was brought up a little earlier here, that you can always reach a point at some distance where you drive traffic away from the railway; but we are far, far from that point yet.

Q. So that the stock now selling at 17, about 70% of its par value, you think that it should go back to par; then you could start ---

A. I would like to see it; I would like to see it at par.

Q. We are at 70% of par now, and I want to know, Mr. Crump, as senior Vice-President of this company, do you expect the freight rates to put this stock back to par?

A. I would certainly like to see it."

Now, Mr. Thompson, you are aware that the stocks of regulated companies, utilities, in other words, or quasi-utilities, sometimes sell in the market under par?



A. In some instances.

Q. What did you say?

A. I said in some instances.

Q. I have taken the trouble to have an examination made of the price ranges of market prices of certain utility and railroad preferred and common shares, and I would like to offer this as an exhibit.

MR. EVANS: How are we going to prove this?

THE CHAIRMAN: Of certain railways?

MR. FRAWLEY: Of certain utility and railroad preferred and common shares.

THE CHAIRMAN: In Canada?

MR. FRAWLEY: In Canada and in the United States.

MR. EVANS: May I say that I don't know what these are. I don't know whether they are representative utilities.

THE CHAIRMAN: Are these market quotations?

MR. FRAWLEY: They are price ranges. This information is taken from Poore's and Moody's reference books.

THE CHAIRMAN: What are you seeking to establish by that?

MR. FRAWLEY: Just to establish that it is not at all uncommon for the stock of a regulated company to go below par, and to sell in the market at less than par for given periods of time.

THE CHAIRMAN: Markets in general have their ups and downs.

MR. FRAWLEY: That is right.

THE CHAIRMAN: Every stock has its highs and lows.

MR. FRAWLEY: The whole purpose of the exhibit is to deal with the statement by Mr. Crump. We have it from Mr. Crump and we had it in the revenue cases by Canadian Pacific witnesses that the freight rates must bring these stocks back to par.





MR. EVANS: What do you think has brought them up to 17 in the case of the Canadian Pacific? In the 20% case we had a lot of exhibits on this very kind of subject put in evidence and proved through witnesses, commented on by a witness, two experts in fact. If my friend wants to introduce this kind of evidence -- it is a very technical subject --

THE CHAIRMAN: You are telling us about the evidence in the 20% case. What was it directed to show?

MR. EVANS: To show just what utilities elsewhere have been earning, and to derive from that a conclusion as to what they need to earn, but my friend, instead of putting this information in through a witness, simply files a document on which we cannot cross-examine. Even if we tried to cross-examine our friend, Mr. Frawley, I am sure he could not answer the questions we would put to him. It does seem to me an unusual way to put in that kind of evidence.

THE CHAIRMAN: Could you not have handled these exhibits through Mr. Morrison?

MR. FRAWLEY: Yes but as I say it is simply a compilation taken from recognized reference books showing the range of market prices of stock --

THE CHAIRMAN: Yes, but you cannot say now that this document is precious, that it must not be questioned.

MR. FRAWLEY: Oh no.

THE CHAIRMAN: Would it not have been better if you had had Mr. Morrison produce it and tell us what he thought about it and the value he gives it, and then Mr. Evans could cross-examine him.

MR. FRAWLEY: Mr. Morrison has gone back to Calgary but I will bring him back.

THE CHAIRMAN: I am just saying what I think might



have been done. As Mr. Evans says, how can he cross-examine sheets of paper, test their value or establish anything?

MR. FRAWLEY: I suppose somebody could go into the box and say that he took the first item from page so and so of Moody or Poore., and that is all he could say. Then it speaks for itself.

THE CHAIRMAN: Moody and Poore - what do they show, how the stock stood on a certain date or through a range of weeks or months?

MR. FRAWLEY: It gives complete information on the range of the stocks.

THE CHAIRMAN: What is it you are trying to show us, that companies do survive and operate although their shares are being sold under par?

MR. FRAWLEY: And regulated companies, sir, companies that are regulated by public utility boards. That is the importance of it in my submission, and the fact they are below par is apparently no matter of amazement. The company goes along.

THE CHAIRMAN: How do we apply that to the Canadian Pacific? Its stock has been selling below par and it is going along, but does that mean to say that everything is happy with them?

MR. FRAWLEY: That in itself should be no concern, and I did not raise the question. The question was raised in the revenue cases and we heard it again from Mr. Crump, that the freight shippers of Canada must bring the Canadian Pacific stock back to par. I say that is not our position.

THE CHAIRMAN: Suppose you bring us figures to show that there are 100 companies operating in Canada whose shares are being sold under par --

MR. FRAWLEY: And they are regulated companies.



THE CHAIRMAN: Suppose that exists; then what?

MR. FRAWLEY: I say it neutralizes the force of the evidence given against me that it is the obligation of the freight rates to bring the stock back to par.

THE CHAIRMAN: Then, Mr. Evans, what do you say to that bare statement which shows that a great number of regulated companies are operating with their shares being sold under par? Then what?

MR. EVANS: I should say that it might simply prove exactly what we say, that they need more money in their rate structure. It might prove something entirely different.

THE CHAIRMAN: Would you call each company to speak for itself?

MR. EVANS: No, sir, I would expect this. If my friend wants to draw conclusions from information of that kind the only way they can be drawn is by somebody who is an expert in these things drawing a conclusion in the witness box from the compilation of figures. I have not the slightest objection to my friend doing that, not a particle. We did it in the 20% case but we put them in the box and they were cross-examined.

THE CHAIRMAN: Isn't Mr. Thompson such a qualified person?

MR. EVANS: I am sure I don't know.

THE CHAIRMAN: You have been using each other's witnesses quite freely generally speaking as we have gone along. You used Dr. Locklin, for instance.

MR. EVANS: I never took him out of his book or subject.

THE CHAIRMAN: Pardon?

MR. EVANS: I never took him out of his subject.

THE CHAIRMAN: No. If this is not within Mr.





Thompson's range of knowledge --

MR. FRAWLEY: I do not think Mr. Thompson would admit that or suffer that sort of statement. That is precisely Mr. Thompson's business.

MR. EVANS: No, it is a financial man's business.

MR. FRAWLEY: You under-estimate Mr. Thompson.

THE CHAIRMAN: Ask Mr. Thompson what questions you like and we will see whether you should be allowed to go along or not.

MR. FRAWLEY: Here is the proposed exhibit, Mr. Thompson.

COMMISSIONER INNIS: Mr. Frawley, you have not any additional information showing how far these companies were successful in floating issues?

MR. FRAWLEY: I have been exceedingly mindful of your question and we are presently working on that. We are going to go to some trouble to find out by communicating with the I.C.C. At the moment we have been able to find out exceedingly little. My information is all subject to being supported but I thought I would give it to you very roughly this morning. It appears from a document called I.C.C. Statistics on Steam Railways, statement number 19, which afterwards became statement number 146, where that particular kind of information is collected, that in 1929 there were \$57 million of common stock sold; in 1930 \$43 million, and nothing at all until 1948, \$500,000, and 1949, \$200,000. That is all class 1 railways. I am not offering that information in a final way at all. We are going to communicate with the finance section of the I.C.C. to see if we can answer that question because Mr. Walker, you recall, said, I think, that the Chesapeake and Ohio has rather recently sold some common stock. We are going to try to run all that information down for you.

THE CHAIRMAN: This might be a good time to have a recess.  
----Recess.

(Page 17560 follows)



...ON RESUMPTION

MR. FRAWLEY: Mr. Chairman, in asking for this document to be accepted as an exhibit, might I follow the not unusual practice of asking the Commissioners to look at it and see what it contains, and then make such ruling as you think fit about rejecting it or accepting it.

I call attention to the third page, which is Section C, "United States Rails". The statement does nothing more than to show what the common stock is. Say, take the Baltimore and Ohio - that is not common; yes, Baltimore and Ohio common. The par value is 100; that is an easily established fact. I am mindful of everything counsel say about having a witness in the box, but the par value is 100. We find, looking for certain relevant sources of material, that in 19<sup>49</sup> it sold in the range of 11 3/8 to 7 3/8, and in 1948 it sold in the range of 16 7/8 to 10, and so on. I won't pursue that any further. And you take the Chicago, Burlington & Quincy - -

THE CHAIRMAN: Pardon me, does it pay a dividend?

MR. FRAWLEY: A dividend paid? There was no dividend paid, because that item is already in my statement; there were no dividends paid. But take the Erie Railway - that is preferred. Take Kansas City Southern, common. That has a par value of 100. It paid in dividends in 1949 \$4. That is, per share, I take it - yes, per share. Now then, the selling range was 49 7/8 to 34 1/4; in 1948 from 60 1/2 to 48 5/8. Take the Northern Pacific - -

THE CHAIRMAN: Is there anything about volumes of transactions, sales of shares?

MR. FRAWLEY: No, sir, and I have the Canadian Pacific too on the last page, set up in precisely the same



fashion but its par value is 25. It paid in dividends \$1.25 and its price range in 1949 was from 18 down to 11 7/8, and so on back to 1945. I am only saying, suppose the Board itself picked up these source books and then found this same material and came to conclusions on that. I say the only conclusion for the proposition of the Company is that freight rates must bring its stock back to par. That is the proposition I am endeavouring to meet. I say that even if I don't have a witness at all or even this statement, that the Commission or the staff of the Commission could go into these source books and pick up some information, and it would be unobjectionable and your recommendations could be founded upon that sort of research. It is purely a case <sup>of</sup> research, and if its weight is affected by the number of transactions and they should be added, I take it that particular item could be added. The same source material would give you the volume of sales at these various ranges. It is all factual, sir. That is my submission and I am reminded of that with Mr. Thompson in the box, I don't know why. There are some Canadian utilities in Section B.

THE CHAIRMAN: Yes, well, you see - -

MR. FRAWLEY: But they are not railways.

THE CHAIRMAN: You have not got only railways. So far as the railways in the United States are concerned, so far as that situation goes, you know what their regulation is, what principles are applied in arriving at their rates and so on. But take these other utilities, Puget Sound Light & Power.

MR. FRAWLEY: If your lordship has any question about that, I would withdraw the sheet which deals with non-railway utilities.





THE CHAIRMAN: We don't know what the policy may be in each of these statements.

MR. FRAWLEY: No, that is right.

THE CHAIRMAN: Or what these utilities should yield, we don't know that.

MR. FRAWLEY: What I might do now, in view of your lordship's objection - because I don't want to press anything that might be misunderstood or given a wrong application - I would remove - -

THE CHAIRMAN: It might not be of much value to us because I say we don't know enough about a power company. What is it intended to do?

MR. FRAWLEY: That is right. I would think that looking at Statement A, which covers United States utilities, and then railways, in view of your lordship's remarks, I think that is of doubtful value. Take the next sheet, Canadian Utilities.

THE CHAIRMAN: Doesn't the same apply to them?

MR. FRAWLEY: Then the same thing applies to the other Canadian non-railway utilities, I think so, sir.

THE CHAIRMAN: Yes, then you just leave railways.

MR. FRAWLEY: Just railways.

THE CHAIRMAN: Then you would show that according to statistics of today there are certain railways in the United States the shares of which are being sold at less than par, a great deal less than par, but nevertheless are paying certain dividends and are carrying on.

MR. FRAWLEY: And whose rates are presumably just and reasonable; their rates that are regulated by the - -

THE CHAIRMAN: By the Interstate Commerce Commission.



MR. FRAWLEY: Yes, indeed, sir.

THE CHAIRMAN: All right now, what about that?

MR. EVANS: May I just comment on that?

THE CHAIRMAN: Yes.

MR. EVANS: It seems to me that in order to assess the value to be put on any such stock of a railway that pays a dividend, one must assess the risks that the investor faces in going into that particular railway.

THE CHAIRMAN: One must what?

MR. EVANS: Assess the financial risks that an investor takes in going into that particular security. Now, the Interstate Commerce Commission have never fixed a specified rate of return for a specified railway. Now, it might well be that the one we are considering where they have paid some dividend and the stock is selling below par, is one in which owing to the group arrangement of looking at the rate of return,<sup>it</sup> is one of those that is in the lower bracket. That does not follow that the Interstate Commerce Commission, viewing that railway as a single railway would have said: "You are getting just and reasonable rates". There may be the fact that this company has a very heavy burden of fixed charges. Perhaps it is too high, perhaps injudicious in setting up its borrowings and fixing its fixed charges at a level that does not permit a shareholder a sufficient equity to attract him.

Now, there are so many considerations, and all I am saying is, that it takes a financial man to comment and to express an opinion on this kind of evidence. As a statistical statement, I don't question Mr. Frawley's figures. It is only that no safe conclusion can be drawn from a set of figures on a sheet of paper without some comment by a



financial witness. Now, we have that in the 20 Per cent Case which is before this Commission. All of the tables of similar kind are commented on by our witnesses. I have no objection to Mr. Frawley doing the same thing if he wants to counteract our evidence. He did not attempt to do so before. He may have done for this case. I would not have had any objection.

THE CHAIRMAN: Well, as I take it, all these documents show - and you have to admit it and I have to admit it - is that these companies are now in existence, that their par value of their shares is so much; that nevertheless these shares are being sold at a great deal less, and in some cases they are paying dividends. Now, that is all there is that we can take notice of, you see, and that does not prove very much.

MR. EVANS: That is right.

THE CHAIRMAN: And Mr. Frawley was going to sail through the whole lot. It is just a matter of argument.

MR. EVANS: I know from experience that conclusions will be drawn by counsel from this that are unsupported by - -

THE CHAIRMAN: Those conclusions will be submitted to us.

MR. FRAWLEY: I know from experience that they will all be answered.

THE CHAIRMAN: We will strike out from these documents all <sup>the</sup> other information.

MR. FRAWLEY: We could do it very simply by removing the two top pages.

THE CHAIRMAN: Yes, I see.

COMMISSIONER ANGUS: But, Mr. Frawley, some of the other items puzzle me a little bit. In the case of non-cumulative preferred stock, is it in any sense the duty





of a regulatory authority to see what that sells at?

MR. FRAWLEY: No, I have to compare them, and I only want this document for comparing <sup>common</sup> with the common.

COMMISSIONER ANGUS: The Canadian Pacific has contended that this non-cumulative preferred stock which bears a fixed interest rate, should be kept at par, but that depends on the rate of interest that prevails in the market, doesn't it?

MR. FRAWLEY: I understood their contention, as expressed by one of their witnesses, is that they want the common stock to come back to par so that they can sell some.

COMMISSIONER ANGUS: Yes, but what is the point in putting in the preferred stock at fixed dividend rates?

MR. FRAWLEY: I quite agree now, where these preferred stocks are not comparable. I only want to compare the C.P.R. common with the common of the American roads.

COMMISSIONER ANGUS: Should the preferred stocks be struck out?

MR. FRAWLEY: I would be quite content for the preferred stock to be struck out.

MR. EVANS: May I just make one further comment. If this is to go in at all I would just as soon have the first two pages go in, the whole thing.

MR. FRAWLEY: I cannot offer any objection to that.

THE CHAIRMAN: Well all right.

MR. EVANS: I am not saying I want it in, but if it is to go in I would just as soon have the first two pages.

MR. FRAWLEY: It makes a much neater job.

COMMISSIONER INNIS: What is the number, Mr. Frawley?



MR. FRAWLEY: 204, sir. I take it, Mr. Evans - Dr. Angus raised the question of the comparability of the preferred stock, and I was content that they should be struck out. Now, do they go along?

MR. EVANS: I don't know even what is here. This is the first time I have looked at it. I think there are so many questions.

THE CHAIRMAN: I beg your pardon, I was talking to Mr. Covert. What are you saying?

MR. EVANS: Mr. Frawley asked me to comment on Dr. Angus's suggestion as to the comparability or otherwise of certain preferred stocks. And my answer is I don't know what is here. All I am saying is there are so many questions that could be raised as to the propriety of comparisons of this kind. I think it is all subject to that objection, Dr. Angus.

(Page 17568 follows)



MR. FRAWLEY: There is one thing about it, if we leave in non-cumulative preferred stock, Mr. Evans will have that much more to discuss about it by way of criticism.

MR. EVANS: I may not discuss it at all.

MR. FRAWLEY: That is right. I should not have left myself open for that.

THE CHAIRMAN: You are going to amend this?

MR. FRAWLEY: Yes, I am quite content to amend it in the light of Professor Angus' remark, that the non-cumulative preferred stock that appears in three places on Statement C are not properly . . .

COMMISSION ANGUS: Would you put that in the record?

MR. FRAWLEY: Yes, it could be put in the record.

COMMISSIONER INNIS: We are going to reach a delicate distinction if we draw a line between useless and useful information.

MR. FRAWLEY: Yes. A lot of it wouldn't be difficult at all; it would depend on who you would ask to draw the distinction.

MR. O'DONNELL: What is the heading on that Exhibit?

MR. FRAWLEY: "Range of Market Prices of Certain Utility and Railroad Preferred and Common Shares." It is divided into "A. - United States Utilities. B - Canadian Utilities. C - U.S. Rails. D - Canadian Rails."

EXHIBIT NO. 204:

Range of Market Prices of Certain  
Utility and Railroad Preferred  
and Common Shares.





MR. O'DONNELL: In due course will you provide us with copies?

MR. FRAWLEY: Q. I want to ask about only one other matter, and that is segregation of assets and revenues. I want to ask for your comment on this short passage. First, I should say that you said yesterday that the test was as to whether an asset should be put into rail or non-rail -- that is asset or revenue -- is that the asset produce transportation services. Now, for the record I should find that page for you. You do not happen to have it yourself, do you, Mr. Thompson? I think it would make the record a little clearer if I had that.

MR. COVERT: Page 17487.

MR. FRAWLEY: Thank you, Mr. Covert.

At page 17487 you are asked your opinion as to what should be a governing factor as to whether an item should be classified rail or non-rail, and you answered:

"The governing factor, in my opinion, is whether or not the asset is producing or furnishing transportation service. In that case it should go into rail."

Now, Mr. Thompson, what exception, if any, do you take to this statement which is contained on page 2 of the supplementary submission of Alberta in these financial matters? We make the submission that the regulatory body be authorized and empowered by statute to determine which of the various types of corporate income should be included as rail income and shown in material furnished to the Board in proceedings undertaken for the purpose of determining financial needs for the fixing of freight rates. Do you take any exception to that statement?



A. In other words, the Board should determine what is rail and what is non-rail?

Q. Yes.

A. Well, I would prefer to put it this way: the railway should make the first decision, and then the Board could rule as to whether or not the items were rail or non-rail.

Q. Yes, I think I would agree with you on that.

THE CHAIRMAN: You would have to do that?

MR. FRAWLEY: Q. Any other way would mean that the Board would send its auditors and accountants into the railway books in the first instance?

A. Yes.

Q. You say the railway should make its own segregation, but subject to the approval of the Board?

A. Yes; I would have no quarrel with that.

Q. Would you go so far as -- perhaps you have gone as far as Alberta goes -- to say that that should be a requirement along with the requirement to bring about uniformity of accounts?

A. In other words, that should be mandatory?

Q. Yes, they should be required to put into rail everything that is properly rail?

A. If the Board so ruled.

Q. But if there was a direction that the Board must do that, after all that is pretty fundamental, that the Board must do that.

A. If the Board said it had to go into rail, I don't suppose the railway would have any option?

Q. It is fundamental that the Board must decide what is rail and what is non-rail.

A. After hearing the pros and cons.

1. The first part of the report is devoted to a general survey of the situation in the country.

2. The second part is devoted to a detailed description of the various districts.

3. The third part is devoted to a description of the various districts.

4. The fourth part is devoted to a description of the various districts.

5. The fifth part is devoted to a description of the various districts.

6. The sixth part is devoted to a description of the various districts.

7. The seventh part is devoted to a description of the various districts.

8. The eighth part is devoted to a description of the various districts.

9. The ninth part is devoted to a description of the various districts.

10. The tenth part is devoted to a description of the various districts.

11. The eleventh part is devoted to a description of the various districts.

12. The twelfth part is devoted to a description of the various districts.

13. The thirteenth part is devoted to a description of the various districts.

14. The fourteenth part is devoted to a description of the various districts.

15. The fifteenth part is devoted to a description of the various districts.

16. The sixteenth part is devoted to a description of the various districts.

17. The seventeenth part is devoted to a description of the various districts.

18. The eighteenth part is devoted to a description of the various districts.

19. The nineteenth part is devoted to a description of the various districts.

20. The twentieth part is devoted to a description of the various districts.

21. The twenty-first part is devoted to a description of the various districts.

22. The twenty-second part is devoted to a description of the various districts.

23. The twenty-third part is devoted to a description of the various districts.

24. The twenty-fourth part is devoted to a description of the various districts.

25. The twenty-fifth part is devoted to a description of the various districts.

26. The twenty-sixth part is devoted to a description of the various districts.

27. The twenty-seventh part is devoted to a description of the various districts.

28. The twenty-eighth part is devoted to a description of the various districts.

29. The twenty-ninth part is devoted to a description of the various districts.

30. The thirtieth part is devoted to a description of the various districts.

Q. Always, yes. That is so, is it not?  
The Board must do that?

THE CHAIRMAN: To what extent has the Board made such a decision up to now?

MR. FRAWLEY: Up to now I think I can say that they have not taken into rail anything other than -- I think there is one exception -- but in the main I think they have not taken into rail anything which the railways themselves have not put into rail. I think the exception is some interest on the deferred maintenance fund, which we objected to and said "surely that should go into rail, because the contributions to the deferred maintenance fund came from rail." And the Board -- Mr. EVANS will correct me if I am wrong -- did find that it should go into rail and be taken out of Other Income. I think that is right.

MR. EVANS: I think that is substantially so.

THE CHAIRMAN: Apparently the Board today has acted on these powers it has to segregate . . .

MR. FRAWLEY: That is right.

THE CHAIRMAN: As between rail and non-rail.

MR. FRAWLEY: That is right.

THE CHAIRMAN: You don't suggest any changes . . .?

MR. FRAWLEY: Except for clarity, I would say that the Board should be directed to bring into rail and to require that the accounts be presented in rate cases by the carriers, properly distinguishing rail and non-rail; and it is always subject to the over-riding power of the Board to bring into rail other items which are not there, and contrariwise.

THE CHAIRMAN: If the presentations are made today by the railways is there not sufficient information to





disclose what the different sources of revenue are.

MR. FRAWLEY: In that regard not . . .

THE CHAIRMAN: I mean not only the books . . .

MR. FRAWLEY: No.

THE CHAIRMAN: I don't know what they do.

MR. FRAWLEY: I would say that is rather doubtful and I would call to your attention, sir, the statement of Mr. Commissioner MacPherson in a dissenting judgment. He did not disagree in the result, but he did say in a judgment, reading from page 86 in the 21 per cent case as follows:

"In dealing with Other Income I wish to draw attention to one point in connection with the way in which the Canadian Pacific Railway presented these accounts. I agree that in determining what are just and reasonable rates the income derived from other sources than railway operations should not be taken into consideration, but if that view is correct, I think the accounts should be prepared accordingly, i.e., that assets and income should be segregated and separate Balance Sheets and Profit and Loss Statements presented to the Board on any future application."

That is the length to which Mr. Commissioner MacPherson goes, because he thought the manner in which they had been presented did not sufficiently segregate. Whatever is necessary, my lord, and at the moment I do not think it needs to be particularly harsh in any such direction, but there should be a clear understanding that the Board must have the power to require



the railways in revenue cases to completely segregate between rail and non-rail, their assets and revenues.

THE CHAIRMAN: The Board itself would have sufficient information to compare all these items to determine whether this is rail or non-rail.

MR. FRAWLEY: That is right; and I would be content with the technique which Mr. Thompson suggested, that if the railways come in on one basis they should be subject to scrutiny and argument.

THE CHAIRMAN: Mr. Evans has something to say.

MR. EVANS: Before my friend goes on -- I do not want to be in the position of contradicting my friend, but I do suggest that the judgment of Mr. Commissioner MacPherson cannot be construed in the way in which my friend construed it. The question put to my friend was this -- and I think it was put by you, sir -- Has there been any difficulty in obtaining the necessary information?

THE CHAIRMAN: I did not use the word "difficulty". I said, so far have the railways not presented to the Board in each case sufficient information to show just what the nature of each one of these institutions is in which it is interested, so that the Board could determine whether this is rail or non-rail.

MR. EVANS: My answer to that is this -- although I may differ from my friend -- there is no question about that. We supplied an immense amount of information. What Mr. Commissioner MacPherson is talking about is the way the accounts are completed. He thinks there should be a separate Balance Sheet and separate Profit and Loss Account. That is quite a different thing from discussing the question as to whether the Board had before it sufficient



information to assess these things. At no time have the railways -- the Canadian Pacific, and certainly so far as I know, the Canadian National, ever failed to give whatever information was necessary to the Board. We give enormous amounts of information.

THE CHAIRMAN: Supposing, Mr. Frawley, a certain item which the railway is interested in is held by the Board to be non-rail -- and even to your own satisfaction, as being a fair determination that it is non-rail -- are you further interested to know anything more about that investment?

MR. FRAWLEY: No; <sup>if</sup> it is excluded properly as non-rail, and excluded from the rates cases, as it were, I have no further concern with it. I do not want to prolong the argument about Mr. Commissioner MacPherson's dissenting judgment, but you asked me, sir, if the Board had always --

THE CHAIRMAN: I asked you to what extent, if any, had the Board decided these matters previously.

MR. FRAWLEY: Yes; and I read out that short paragraph from the judgment showing that, in the opinion of Mr. Commissioner MacPherson there was some difficulty, something was wrong in the manner in which they had submitted their accounts. I say "wrong" not in any invidious sense. My friend is aware of the struggle that went on there for months, and us trying to find out about Other Income.

MR. EVANS: Oh, oh, Mr. Frawley --

MR. FRAWLEY: Yes.

MR. EVANS: The struggle did not go on for months trying to find out about Other Income. The struggle went on for months because my friends were trying and





persisting in getting Other Income taken into account --

THE CHAIRMAN: I don't suppose anybody would want us to decide on what point the struggle went on for months.

MR. FRAWLEY: That is right.

MR. MACPHERSON: I think the points were, sir, there was a great deal of information furnished by the railway, but it was presented at the insistence of the provinces. I think probably the provinces' complaint in this connection would be that <sup>the</sup> Board itself had not required the information, which ultimately the provinces insisted be brought out.

MR. EVANS: I do not wish to prolong this but --

THE CHAIRMAN: If the Board is to decide definitely and in a binding manner on all concerned, what is rail and what is non-rail, it stands to reason the Board must in each case have sufficient information to arrive at that decision.

MR. FRAWLEY: Yes, and that can only come largely from the railways.

THE CHAIRMAN: That is a matter which I presume the Board itself would have to work out.

MR. FRAWLEY: That is right.

MR. EVANS: I would like to make this statement: I am not going to contradict Mr. MacPherson, but what the Board required for these purposes and what my friends asked is another matter. My friends got from us a volume that thick -- and I measure it to be about two to two and a half inches thick -- of the financial statements of the subsidiary companies. We objected to producing those because of the work involved, and because we said they would not be useful; and they proved not to be useful.



They were asked for as necessary in the study of apportionment of fixed charges and dividends.

THE CHAIRMAN: They are still there?

MR. EVANS: They were never used by my friends.

THE CHAIRMAN: But they are still with the Board.

MR. EVANS: Yes, sir.

THE CHAIRMAN: They will be of use now.

MR. EVANS: They are out of date now.

MR. FRAWLEY: My friend makes that statement; it is a bad statement to make. They were asked for to enable a study to be made of apportionment of fixed charges and dividends, and they were used for that purpose. I was one of the ones who asked for them; and my friend Mr. Smith from Nova Scotia and I were charged with that work, and we laboured long hours on those statements to enable us to determine the necessary information to enable an apportionment of fixed charges and dividends. It is quite wrong to say they were not used. We made good use of them.

MR. EVANS: You did not use them . . .

THE CHAIRMAN: I suppose Mr. Evans<sup>means</sup>/that you did not say much about them before the Board.

MR. FRAWLEY: No, but we informed ourselves from them; they were necessary to us.

MR. SMITH: On the apportionment of the fixed charges in the light of these documents --

THE CHAIRMAN: Did these documents reveal sufficient information for you to make up your minds on it?

MR. FRAWLEY: Yes; and we made up our minds on the basis of that information.

THE CHAIRMAN: These documents are with the Board now; they are Exhibits.



MR. FRAWLEY: I don't know whether they are Exhibits now.

THE CHAIRMAN: They are there; and if they are sufficiently descriptive and explanatory of the conditions surrounding each item, they are there.

MR. FRAWLEY: Yes. To be exact about it, they were given to us in response to our demands, and we took them in to our accountants and they were looked over. As to the documents, many of them were not produced; only some of them were produced.

THE CHAIRMAN: What did you do with them?

MR. FRAWLEY: We used them; they were our working papers, so to speak.

THE CHAIRMAN: Have you still got them?

MR. FRAWLEY: Of course, sir.

THE CHAIRMAN: They might be valuable now.

MR. FRAWLEY: Yes. My friend described them as so big. They were pieces of mimeographed paper handed to us showing a proper list of Alberta stock held --

THE CHAIRMAN: They were two and a half to three inches thick.

MR. FRAWLEY: Yes, two and a half to three inches thick. The way my friend tells it, you would think it took them six months, or so many man hours.

MR. EVANS: Well, I will tell you --

MR. FRAWLEY: My friend is going to say it took a thousand man hours.

THE CHAIRMAN: I have something to say. If this documentary evidence has been compiled and used by you to your satisfaction about the nature of these various investments that the railway is interested in, it is there for all time, is it not?





MR. FRAWLEY: Yes; and could, I say, be filed with the Board if this matter came up again.

MR. SMITH: It was furnished as a result of an order of the Board, to indicate that matter particularly.

MR. FRAWLEY: That is right.

THE CHAIRMAN: However it came about, it is there.

MR. FRAWLEY: That is right. It is for one year; by the time we get to using it again it may have become rather obsolete. We may want it for another year.

THE CHAIRMAN: It may be obsolete, but it is a good starting point.

MR. FRAWLEY: It is subject to depreciation over there.

Q. Mr. Thompson, I have asked you to look at this test of yours, that assets produce transportation services. Wouldn't you say that an equally good test would be -- is it reasonably ancillary to the rail enterprise?

THE CHAIRMAN: You mean the test?

MR. FRAWLEY: To test whether an item is rail or non-rail. This test I am content to have made by the Board, of course.

THE WITNESS: I prefer my own description.

MR. FRAWLEY: Q. But you do not see too much objection to be taken to my expression, reasonably ancillary to rail enterprise?

A. I think you would have to look at each activity and make a decision on what you found out as a result of your examination. Just to pin it on the word "ancillary", I wouldn't care to do that.

Q. We must not attach too much to one word.



You say, what produces transportation services. I was thinking of a big stockyard, like the Alberta stockyard in Calgary, which the Canadian Pacific owns. How would that fit into your definition or mine? Would you say it was reasonably ancillary to rail enterprise, according to my test, or would you say it was producing transportation services?

A. I am not sure just how those stockyards are operated, I mean whether there is a private company; and, in fact, I am not quite sure how they are taken into the C.P.R. accounts.

Q. Other Income.

THE CHAIRMAN: Mr. Frawley, have you not yourself filed an Exhibit setting out a list of the things that you say are to be considered rail and those things which you say are on non-rail, in your opinion? I mean, there is an Exhibit before us now.

MR. FRAWLEY: Sir, there was a page in the September last judgment.

THE CHAIRMAN: I think it is the Canadian Pacific --

MR. FRAWLEY: Yes. . .

THE CHAIRMAN: You commented on it the other day. I think there are nine items where there is --

MR. FRAWLEY: Yes, sir; in the judgment it is 1947; I think that is 1947 itself, with the hotels added; it is the same information.

THE CHAIRMAN: I think you referred to the Exhibit yourself the other day, and there were certain items you considered rail and other items you considered non-rail?

MR. FRAWLEY: That is right, sir.



I did not propose to take Mr. Thompson through them all. I think I want more regarding his test.

THE CHAIRMAN: Did you not say the hotels were non-rail?

MR. FRAWLEY: That is right; and other items which are properly rail are the Toronto Terminals and Northern Alberta.

THE CHAIRMAN: If you confine yourself to the items that you consider to be rail, perhaps not all in this Exhibit --

MR. FRAWLEY: No, not all here.

THE CHAIRMAN: And ask Mr. Thompson whether he agrees with those, whether this particular matter is rail, for instance.

MR. FRAWLEY: Yes, I can take him through that.

THE CHAIRMAN: I think that would be an easier way than talking in the abstract of what is reasonably ancillary.

MR. FRAWLEY: He has already touched two of them in his evidence in chief. I am reading from page 13 of the judgment of last September.

THE CHAIRMAN: The 8 per cent judgment.

MR. FRAWLEY: Q. You have it there, Mr. Thompson?

A. Yes, I have it.

Q. You have your own test that you gave us yesterday in front of you. Now the communications, you told Mr. Evans yesterday that you would put that into non-rail?

A. I said this --

Q. Or did you?





A. I said that as far as communications are concerned --

Q. What page?

(Page 17583 follows)



A. Page 17487. I said:

"I have the same view there, that the rail activity should only be charged with the cost of furnishing communication services to the railway."

Q. I take it from that that the commercial operation of the Canadian Pacific Telegraphs, then, in your view should not go into rail -- the net revenue from the commercial operation?

A. That is right.

Q. As a matter of fact, Mr. Thompson, you would not disturb the status quo at all?

A. No.

Q. Well, it is very short. You support everything that the Canadian Pacific has done?

THE CHAIRMAN: On that very point, you disagree, do you?

MR FRAWLEY: Oh, yes. Telegraphs is an operation reasonably ancillary to the rail, and grew up as a result of the rail operation. In any event, those are our submissions with respect to that.

THE CHAIRMAN: Now I want to find out the working of the plan you suggest. If you had this very same question before the Board and they were to decide against you, that would settle it.

MR FRAWLEY: That would settle it. I am not saying---

THE CHAIRMAN: I don't say you would be happy over it.

MR FRAWLEY: No; nor would we appeal, but, having exhausted our remedy, it would be accepted, sir.

Q. Then these other items, Mr. Thompson, on page 13, you do not regard them as rail investments?

A. No, I do not regard them as rail investments.



Q. You do not regard the Toronto Terminals Railway Company as a rail investment?'

A. No.

Q. Do you see any difference in the physical operation of the Toronto Terminal and the Calgary Terminal? You have travelled through both of them many times?

A. Well, of course, one is a small railway terminal and a small station.

Q. Just a little small town, Calgary?

A. A cow town.

Q. A cow town, really, yes; but, apart from that, it is operated the same, it admits and receives and sends on the Canadian Pacific freight and passenger trains?

A. Yes, but I think you have to take this into consideration: The Toronto Terminal is a joint facility; there are two railways involved there.

Q. That is right; and that makes all the difference. As soon as they get concerned with another railway, you say that takes it entirely out of the class of a rail enterprise and makes it a non-rail enterprise?

A. Well, don't overlook this, that the cost of operating that facility, the expense, is reflected in the railway operating expenses of the two major railways.

Q. Mr. Thompson, isn't it just an accident, just a necessary accident, that they had to set up a subsidiary company so they could each have an undivided one-half share?

A. Oh, I don't think so.

Q. In your practice you have had many, many instances when a joint interest required the creation of a subsidiary company?

A. Yes. Well, in those cases, of course, it would be treated as a subsidiary company, continue to be treated.

Q. Well, this has continued to be treated as a sub-





sidiary company, hasn't it?

A. Yes, but the expense of the Toronto Terminals appears in the railway accounts.

Q. I know, but that is just the form of it; the substance of it is that the Canadian Pacific officers and the Canadian National officers operate that terminal?

A. That is correct.

Q. Sure. They may call them an officer or president or manager of Toronto Terminals Railway, but to all intents and purposes they are Canadian Pacific and Canadian National officers?

A. Yes, I understand so.

Q. And probably the same sort of man, a terminal superintendent that they have at the Calgary station, the same kind of man operates for the Canadian Pacific at the Toronto Terminal; wouldn't you think so?

A. Quite possibly.

Q. You would be surprised if it was any different at all?

A. Yes; probably a higher ranking official.

Q. Yes, he probably gets paid more in Toronto?

A. Or Calgary.

Q. And the yardmaster would be the same sort of man, and so on; there is not any difference in the physical set-up?

A. Well, of course, I am not a railroad man; I mean, I cannot express---

Q. Well, you are separating rail and non-rail?

A. By a test.

Q. By an accounting test?

A. By an accounting test.

COMMISSIONER ANGUS: Would it make any difference to your opinion, Mr. Thompson, if the terminals were owned



by one company only?

A. And the other company paid a rent?

Q. Or did not use them. I mean, suppose you had a company that had a separate subsidiary company operating a terminal for it?

A. Well, my view does not change there, because the cost of operating would be paid by the company using the facility. The Terminal Company is created purely for the purpose of operating this particular facility. The cost of that is ultimately reflected in the carrier's accounts. It is charged to him, he pays for it, and he shows it as rent of joint facilities or use of joint facilities.

MR FRAWLEY: Q. Mr. Thompson, for years the Canadian Pacific Railway had a large terminal at North Toronto; did you ever have occasion to use that terminal in North Toronto?

A. I do not recall having used it.

Q. I think it has been discontinued now. That terminal was operated purely as a Canadian Pacific enterprise?

A. Well, of course, I do not know anything about the terminal, that particular terminal.

MR FRAWLEY: Perhaps my friends can tell us something about that.

COMMISSIONER ANGUS: Q. When you say the cost was shown in the railway's accounts, the cost of operating the terminal, do you mean the operating cost or do you mean also the interest on the investment?

A. Oh, I would include the interest on the investment.

MR FRAWLEY: Thank you, Mr. Thompson.

THE CHAIRMAN: I do not want to protract things, but I used this Exhibit 189 just now, and I notice that it speaks of a list of enterprises which have been suggested



from time to time as being includeable in Canadian Pacific Railway account; suggested by whom, Mr. Evans?

MR EVANS: By the provincial counsel.

THE CHAIRMAN: What has the Board done with all these different nine items? Has it included any of them?

MR FRAWLEY: No, they have not; and what they have done about it appears at the bottom of page 13 of the judgment of last September, because, after having cited them, then in two paragraphs they point out the difficulty in which at that time they thought they found themselves:

"The respondents" -- that is, the provinces -- "directed the Board's attention to the fact that the Canadian Pacific Express had made a profit of \$253,363 for the year 1947 but paid out to the Canadian Pacific Railway by way of dividends only \$120,000, leaving \$133,363 carried forward in their surplus. They asserted that this sum of \$133,363 should be properly taken up in the Canadian Pacific Railway accounts and included in Rail Income.

Counsel for the respondents have also maintained that if Other Income is not to be considered in fixing a level of freight rates that this Board exercise active control over the establishment of what is rail income and what is Other Income." The very matter we have been discussing, my lord.

"The foregoing contention points directly to a fundamental difficulty experienced by the Board -- that the Railway Act does not, in its present form, give the Board authority to control the accounting procedure of the railways in the manner advocated by counsel." So the matter stands there, sir.

THE CHAIRMAN: They say they have not got the





statutory power.

MR FRAWLEY: No; and therefore they certainly have not been taken into rail income.

THE CHAIRMAN: None of these?

MR FRAWLEY: No, none of these.

THE CHAIRMAN: None of these nine items?

MR FRAWLEY: None of these nine items.

THE CHAIRMAN: Is that the judgment in the 20% Case?

MR FRAWLEY: This is the judgment in the 8% Case of last September, sir, page 13 of the judgment of the 20th of September last. And I think I can 'say, sir, that that situation remains the same in the light of the judgment handed down on the 1st of March by the Board, in which they brought the 8 per cent up to 16 per cent.

MR EVANS: My friend has made another statement that I am bound to challenge.

MR FRAWLEY: The last one?

MR EVANS: I did not say which one it was; I have not said yet, but I will tell you.

The paragraph on page 13 of the interim increase of September 1949 would not, in my submission, be any possible suggestion of a lack of power to leave in or take out specified matters of Other Income.

THE CHAIRMAN: What is it they said there about not having the statutory power to do what counsel suggests?

MR EVANS: "The foregoing contention points directly to a fundamental difficulty experienced by the Board -- that the Railway Act does not, in its present form, give the Board authority to control the accounting procedure . . ."

Now, that is all that says; but the Board's judgment on



this question of Other Income is very clear in the 21% judgment at page 18, and that runs on for about five pages. They review the authorities, they review the contentions, and the Board for many years has discussed this thing and has had that before it.

THE CHAIRMAN: Did they complain anywhere of a lack of sufficient knowledge to decide things?

MR EVANS: To my knowledge, no.

MR FRAWLEY: Now, my lord, I certainly must call the Board's attention to something which the Board in the 21% Case said, at page 25, because there, you see, we made the submission that if Other Income was not to be taken into account, all of it, and added to the rail revenue, then at least fixed charges and dividends must be apportioned. At page 25 the Chief Commissioner, Colonel Cross, dealt with that, and said:

"The Respondents took exception to the inclusion among the requirements, particularly of the Canadian Pacific Railway Company, of any fixed charges and dividends that might be attributable to ancillary services of a non-rail transportation nature. A pro-rate was made by Mr. Frawley, counsel for Alberta, in argument, of the fixed charges of the Canadian Pacific Railway for the year 1946, by taking as a basis for apportionment of these fixed charges the respective amounts which he claimed to be investment by the railway in railway transportation and non-transportation facilities. The result of his analysis indicated that \$14,000,000 would be a proper amount for fixed charges applicable to railway property and \$4,400,000 applicable to non-transportation properties.

It may be that some part of the fixed charges of the Canadian Pacific are attributable to non-



transportation enterprises. But because of the close relationship of railway transportation and other enterprises of the company I have not been able to calculate with any degree of satisfaction what the amount, if any, may be."

And I say that it is clearly to be inferred from what Colonel Cross said there that he found it impossible because of the intermingling of the two enterprises to make the division which he otherwise perhaps would have made.

MR EVANS: My friend is dealing with an entirely different subject there. I do not want to prolong this thing indefinitely.

THE CHAIRMAN: It is a different subject.

MR EVANS: Very.

THE CHAIRMAN: But an important one, and one that we shall have to hear more about.

MR EVANS: I quite agree, sir; but I do want to say this: When you are talking about apportionment of fixed charges, my friend is suggesting that we have some kind of fixed charge obligation, fixed on say one of these assets, and that would be attributable to that asset, but that is not the way the company conducts its business. The difficulty about saying which fixed charge is on which asset is that the fixed charges are usually charges on all the assets of the company. It makes no difference what they are. Every dollar of the company's asset is charged with the debt obligation -- debenture stock; it is not a debt. That question was resolved in a different way entirely. They tested the level of fixed charges and found it reasonable for rail, in the light of the investment.

MR FRAWLEY: But he says as plainly as anything, "I have not been able to calculate what the amount should be," and that was at least a fair inference from that, that





there was something---

THE CHAIRMAN: Are you saying that he ought to have had the proper evidence before him?

MR FRAWLEY: I do, sir. I say that he should have done it himself; if he did not like the way I suggested it, he should have done it himself, and indeed that is what the Governor in Council said they should do, and they have now done it, as to fixed charges but not as to dividends.

COMMISSIONER ANGUS: If Mr. Brazier will forgive me for a moment, there is a question I should like to ask Mr. Thompson.

Q. We have had a good deal of comparison between freight rate cases that turn on requirements and those that turn on a rate base and a rate of return, and it has been suggested, I think, that the latter method, the rate base and the rate of return, would simplify things very much and would be much more convenient and would dispose of a good many of the issues that have been raised before us here. The question I wanted to ask was this: Should the two methods, each properly applied, give identical results as far as the ultimate freight rates are concerned, the ultimate level of freight rates? I am asking that question because I think we have been comparing requirements measured pretty strictly, or relatively strictly, with a rate base measured relatively generously; I am not sure whether we have been comparing like with like in that case.

A. Well, the difficulty there, of course, is this, that if you make the approach on the basis of requirements it depends what you put into your requirements and the total which is finally determined as your requirements. That can be compared with the other approach, which is the



rate base approach, and the rate base approach shall we say uses a yardstick of the other method of approach. You could, of course, I suppose, arrange the figures so as to be exactly the same, but that would depend on shall we say the amount which you put in the requirement approach for surplus.

MR EVANS: May I say what we proved, or the position we took in the rate cases? We took this position: We said that it might be quite improper for us if we had fixed charges of \$30 million and a whole lot more stock to service than we had, to suggest that the rate formula should provide enough money for that. We said, "You have got to test them in the light of the investment in the rail properties." We said, "We don't expect you to say, if we have got no fixed charges, that we have no requirements, nor do we say if we had \$50 million of fixed charges that those should be the requirements. You must always test them in the light of what you are giving us in terms of investment."

COMMISSIONER ANGUS: Q. I understand there would be this difference, Mr. Thompson, that almost any calculation by means of rate base would give the company the benefit of any profit it had made by trading on the equity, if it were getting part of its capital at a lower rate than its common stock, while the requirements method would assess rather closely what they had to pay on their fixed charges, and if they made a good bargain on their fixed charges would pass that on to the shippers. But, apart from that difference, is there an essential difference between the two things? Does the use of the rate base method import as an essential part of it a rate that is independently determined?

A. I think so. I think on the rate base approach



you must fix a reasonable rate of return. It is a corollary of that particular approach; you can't escape it. To my mind that is the best approach, because you avoid so many of these contentious questions -- in other words, how much should be earned by this utility on its investment, assuming a reasonable rate of return on that investment, on property used and useful to the undertaking?

Q. In that case we are really dealing with two competitive and mutually exclusive standards of fair and reasonable rates; I mean, rates that would be fair and reasonable in terms of requirements would not be fair and reasonable in terms of rate base and rate of return?

A. That is possible.

Q. And inversely?

A. Yes.

Q. Now, the problem that I am leading up to there is, if a decision has to be made for changing over from one concept of fair and reasonable to a different concept of fair and reasonable, is that a decision that it was ever contemplated that the Board of Transport Commissioners should make, or is it a decision that really is of sufficient importance to require a parliamentary decision? Perhaps that is not a fair question to ask you, but that is what I was leading up to.

A. Well, I don't mind answering it. I give my own view. I think that should definitely fall within the jurisdiction of the Board of Transport Commissioners. It is the type of approach which is commonly used by most regulatory bodies, and I think the power properly belongs there, without being prescribed by statute.

Q. And can they make that decision and act on it without saying, "The rates which we fix now are fair and reasonable, and by implication the rates which we fixed in





our last judgment were not fair and reasonable"?

A. Well, of course, I think it would depend on the conditions which obtained in each instance.

Q. Well, thank you very much.

MR BRAZIER: Mr. Chairman, as one who had something to do with this question of what is rail income and what is non-rail income, I would like to take exception to the interpretation that my learned friend Mr. Evans puts on the paragraph on page 13 of the 8% Case judgment. Now, while I cannot say whether or not this question of investigating what is rail or what is non-rail had ever been placed before the Board on any previous hearing, I think I can safely say that in this judgment is the first time that they ever took any notice of the argument, and it was the argument that I had put up to them at that time, that if Other Income was to be excluded, then the Board should be required, and it had a duty under the Act, to examine into those accounts and see and decide what is rail and what is non-rail, and I say if you read that full page 13 you must certainly come to the conclusion that what the Board is saying is that at the present time it has not the power to decide or to tell the C.P.R. that this is to be rail and that is to be non-rail, that they had to accept the company's submission that it was non-rail. There is no doubt that over the period of these rate cases the Board has always taken the position that Other Income was not to be taken into consideration. As I say, as far as I know--

THE CHAIRMAN: You mean non-rail?

MR BRAZIER: Yes -- what is called Other Income or non-rail income should not be taken into consideration; but this is the first time that I know of in any judgment of the Board where notice has been taken as to the propriety of



certain items being classified as non-rail, and I suggest the Board is clearly saying there that it finds itself in the very difficult position that it has not the power under the present Railway Act to say to the C.P.R. that that particular item is a rail item.,

THE CHAIRMAN: Are you submitting that the Board in fact has the power?

MR BRAZIER: No.

THE CHAIRMAN: You want an amendment?

MR BRAZIER: That has to be amended. That is one of the amendments that I am preparing.

THE CHAIRMAN: All right.

CROSS-EXAMINED BY MR BRAZIER:

Q. Mr. Thompson, are you familiar with Exhibits 200 and 201 that were put in yesterday, the exhibits from the 20% Case, 49-25 and 49-26?

A. Yes.

Q. You have seen those before too, haven't you?

A. Yes.

Q. Am I correct in saying that these exhibits, these two exhibits, are an attempt to rationalize the reasonableness of the depreciation rate struck by the C.P.R.?

A. Well, I would not agree with the word "rationalize". I would say to test the reasonableness of the rate.

Q. Well, I will accept your word "test" instead of "rationalizing". Now, let us presume that you have a client, Mr. Thompson, who comes in to consult you in your professional capacity -- and, just to simplify it, let us take the figures on Exhibit 200 under the heading "Locomotives", because I think the principle will apply throughout -- and he submitted the figures that are on that sheet to you for your consideration; would you in your professional



capacity certify that the rate of depreciation of 4.1¢ per mile was a proper rate to take?

. Not without making a study of how he arrived at the 4.1¢.

Q. And that is a thing that has never been done in these rate cases, is it not?

A. Not as far as I know.

Q. And you would not consider, then, that the Board of Transport Commissioners were unjustified in not accepting that, when they were not in a position to test that rate?

A. No, I think you have got to look at it in another way, and that is this, that taking the 4.1¢ rate, and without making a study, you can arrive at the indicated average life, and you can compare that with evidence given by other people independently of what the indicated average or what the average life might be. Then I would consider if one compares reasonably closely with the other it is an indication, a very definite indication, that the rate which is struck is reasonably correct.

Q. And if you had just that information and this client came in to you, you as a Chartered Accountant would certify as to the rate being a proper one?

A. Well, I think, of course, you are postulating different circumstances. If I were asked to certify to this statement, which is now what you are asking me to do, naturally quite apart from the rate I would like to look at the ledger value to establish that, and the number of units. I would want some proof of each item appearing in that, there is no question about that, if I were certifying.

---The Commission adjourned at 1:00 p.m., to meet again at 2:45 p.m.





Thursday, March 9, 1950.

A F T E R N O O N   S E S S I O N

JAMES C. THOMPSON - Recalled

CROSS-EXAMINATION BY MR. BRAZIER - Resumed:-

Q. At the adjournment, Mr. Thompson, I think you were explaining to me what you would do if you were asked to pass an opinion in a professional capacity in regard to this depreciation - -

THE CHAIRMAN: What is that you say?

MR. BRAZIER: Q. The depreciation statement on Exhibit 200. I think you were just saying that you would want to have the number of units in service checked.

A. Yes, if you are certifying a statement you would naturally make reasonable tests.

Q. You have already said you would check the ledger value?

A. Yes.

Q. Now, what would you do regarding the depreciation rate per mile, 4.1¢?

A. Well, of course, that is, as you know, based on a study which was made by the C.P.R. and an engineering study, and I think on that you would have to rely on engineering opinion.

Q. You would want to see the study itself, wouldn't you?

A. I would examine it.

Q. So far as you are aware in these rate cases, that study has never been examined by the Board or any of the provinces?

A. Not as far as I know.



Q. Now, one other thing with regard to Exhibit 200. I draw your attention to the fact, Mr. Thompson, that the ledger value and the number of units are taken as at January 1, 1948. Now, as far as equipment is concerned, that would not be the same equipment as a group, as the C.P.R. were using in the year 1940, would it?

A. No.

Q. It would be new units that had been added to it and other units retired presumably during the period?

A. Presumably.

Q. Therefore do you think the exhibit is of any value when they try to use the average mileage of the year 1940 without relating it to the equipment of that year?

A. Yes, very definitely, because I think in making any test of the rate you would have to take the average mileage either predicated upon what might be termed a normal year, or alternatively a period embracing, say, 10-15 years or, as in this case, 14 years. I think it is a perfectly fair method.

Q. I suggest that what you would want to do would be to compare it with the average expectancy during the period in which the rate was to be effective, rather than something in the past?

A. No, I would not agree with that.

Q. You would not agree with that at all?

A. No.

Q. And you think that the rate which was established in 1940 as far as locomotives are concerned, can be partly tested on averages going back some years into the past?

A. In this particular case, yes.

Q. Would not you also have to take into consideration the expectancy of increased volume of business in the future?



A. Well, I think what you have to do there is this, that you make periodic tests; you keep the matter under constant review (there is nothing static about it) and every, say, five or ten years, review the situation and, if necessary, adjust the rate. You would have to do that on a straight line basis as well as a user basis.

Q. You would test it though or you were testing it in the year 1948, you would test with the equipment and ledger value and the mileage of that year, would not you?

A. No, I would take the ledger value at the beginning of the year 1948. As far as the mileage is concerned, I would base it, as I have already said, on what has happened in the past in order to determine what would be a reasonable average annual mileage.

Q. Even if you were satisfied that the average annual mileage in the future was likely to be greater than it had been in the past?

A. Well, of course, it is hard to forecast what is going to happen in the future in the mileage question. I think this is a fair code.

Q. What I am trying to get at is this. It is a factor that you would have to take into consideration. If you were satisfied by some means that in the future your average annual mileage was going to be greater than it had been in any period in the past, that is a factor that you would have to take into consideration in testing it?

A. I think in assessing that factor you look to the past and then you test in the future after a reasonable period has elapsed.

Q. One other matter in regard to this depreciation. Would you agree that one test as to the reasonableness of





depreciation rates is the manner or the amount in which the reserve accumulates?

A. Well, of course, the accumulation of the reserve, if it reaches a point which is in excess of, say, anticipated requirements, then I think you would naturally ask the question: "Are the present rates at which depreciation is being set aside, too high?"; and conversely you might reach a position where the accumulated reserve, as a percentage of the investment in railway property, was too low. You might wish to increase rates, but I think you can only do that by periodic examination of the whole situation.

Q. Have you formed any opinion as to the point at which that examination should be made insofar as the C.P.R. are concerned?

A. Well, I understand the rate was adjusted this last year.

Q. Would that be one of the factors, or do you know, that was taken into consideration?

A. I think a test was made. My information is that a test was made because of the fact that the former rate, the rate shown on this exhibit, was proven to be inadequate.

Q. Now, the C.P.R. have just had depreciation in effect ten years on rolling stock.

A. Since January 1, 1940, on rolling stock.

Q. Which is ten years practically?

A. Yes.

Q. And on road property, somewhat less than that?

A. Eight and a half years.

Q. Now, by Exhibit 49-8, which is the Annual Report of the C.P.R. for 1947, the general balance sheet, on page 23 it shows that the depreciation reserves as on that date,



December 31, 1947, stood at the sum of \$324,478,772?

A. Yes.

Q. Is that correct?

A. That is correct.

Q. Now, if we take the ledger value of that property as shown in Exhibits 200 and 201 (and I have added those up)- -

MR. EVANS: You can't do it, because this is a corporate reserve and the other is railway property.

MR. BRAZIER: Q. Do you know how much of that reserve is - -

MR. EVANS: Mr. Liddy gave all the particulars about that. He gave the amount of the depreciable rail property, depreciable rolling stock in rail, he gave the non-depreciable property, and he gave the percentage the reserve bore to the depreciable property, in examination-in-chief.

MR. BRAZIER: Q. Making allowance, Mr. Thompson, for part of that being corporate depreciation rather than rail and adding the values of equipment and depreciable road property as of January 1, 1948, you find that the total value is \$693,073,000. : :

A. I think it is a little higher than that?

Q. I have just taken - -

A. The figures I have which I think were given in evidence by Mr. Liddy, were that depreciable road at that date was, in round figures, \$322 million.

Q. That is shown on Exhibit 201?

A. And depreciable equipment, \$388 million, a total of \$710 million.

Q. Seven hundred and ten.

A. And as against that the depreciation reserves for



road amounted to 148 million, for equipment 190 million, and there was a small reserve for inland steamships of approximately two million.

Q. Taking 710 million as the ledger value and the reserve at 328 million - -

A. Three hundred and twenty-eight did you say?

Q. Sorry, 338.

MR. EVANS: Mr. Liddy gave all that in-chief.

MR. BRAZIER: Mr. Thompson is just giving us the figures, but Mr. Liddy - -

MR. EVANS: But the figure of \$340,653,884 is the figure of reserve for railway property as at December 31, 1947.

MR. BRAZIER: That includes two million for inland steamships, is that correct?

MR. EVANS: I don't know, we didn't give that.

MR. BRAZIER: Q. Take it roughly at \$340 million.

A. Yes.

Q. Now, in your opinion would that indicate to you that the depreciation had been accrued at rather a rapid rate during that period, that ten years?

A. No.

MR. EVANS: It was not accrued. Now, Mr. Brazier, I must insist that you do not put a question that is quite obviously wrong on the face of it. It was not accrued during the ten years. Mr. Liddy gave the charges to working expenses less retirals since the adoption of depreciation accounting of 122 million out of the 340 million, that amounted to 36% of the reserve for railway property. He gave the figures of transfers and credits, transfers from profit and loss and appropriations from profit and loss, and





credits made to the reserve for charges made to working expenses prior to the adoption of depreciation accounting. When my friend suggests that that was accrued in the last ten years, it is not in accordance with the evidence.

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MR. BRAZIER: I will take away the use of the word "accrued".

Q. Would the fact that the depreciation reserve now stands at that figure indicate to you the possibility that a depreciation has been too high?

A. No.

Q. Would you fix any percentage as between the reserve and the asset value at which point that matter should be considered?

A. I think that is a matter which would have to be reviewed annually to ascertain just what the facts were and whether or not the total accumulated at that time, in its relationship to the investment, was reasonable.

Q. Would it be correct to state, Mr. Thompson, with a company such as the C.P.R. that after a number of years the reserve should be maintained at various fixed percentages of the asset value?

A. No, I don't think so, because it is my experience that a reserve of that kind, particularly in a large organization, is subject to very wide fluctuation, particularly in a utility.

Q. Particularly in a utility?

A. Yes.

COMMISSIONER ANGUS: Q. Does your rate base change whenever there is a fluctuation in the reserve?

A. Yes, the rate base is reached by the gross property investment less the reserve. If the reserve goes up the rate base goes down, and on a rate of return basis the carrier gets less.

Q. Assuming, I suppose, that there was a re-assessment of rates?



A. How do you mean, re-assessment of rates? Do you mean depreciation rates?

Q. No, of the freight rates.

A. Well, the amount of money, naturally, which goes into the depreciation reserves is provided from earnings, and if the earnings are sufficient to provide depreciation there will be the normal accrual. If the depreciation reserve reaches a stage where it is considered that it is too high, then a lesser amount would be appropriated from railway earnings; and I suppose it would follow -- it would affect to that extent the freight rates.

Q. Would it follow from that that you would contemplate fairly frequent freight rate provisions?

A. I don't think so. I think that it would be very disturbing to have freight rate provisions, shall I say, on an annual basis. I think a reasonable period of time should be allowed to lapse before one freight rate inquiry follows another, unless of course economic conditions are such that the whole picture is changed. It may be necessary to have rapid hearings. That has occurred in the United States. But normally, if business was normal and going along in an even, smooth manner, then I think a reasonable period of time should elapse before you would have a freight rate hearing.

Q. But during those intervals the rate of return might deviate not inconsiderably from the rate as fixed by the Board?

A. It might.

Q. MR. BRAZIER: Q. Would you expect, Mr. Thompson, a company such as the C.P.R. to find, say,





a 20 per cent difference in the ratio of depreciation reserve to the asset value say in a period of five years.

A. Yes, I know --

Q. You said it would fluctuate widely. I just wanted to check what you meant by "fluctuate widely".

A. That is an increase of 4 per cent per annum?

Q. Yes.

A. Now, the increase, it would depend on conditions. It is possible.

Q. It is possible.

A. Yes.

Q. But would you expect it, as an accountant in a company such as the C.P.R.?

A. Well, that is difficult . . . I don't like to express an opinion --

Q. It may be an unfair question.

A. -- on something which you are predicated -- it is predicated on an assumption, and I would much sooner take a set of facts, rather than just the assumption you put to me.

Q. Unfortunately I guess, Mr. Thompson, we are not in a position where we have another company the same as the C.P.R., in Canada, which we could examine. Have we?

A. Not quite as large.

Q. You would not want to express an opinion on it?

A. I am just reviewing the matter in my mind.

I can think of one rate case I was recently associated with, and there was a very wide fluctuation over a five-year period in the depreciation reserve due to the fact that normal replacements had not been made. That occurs particularly in war periods. And I think



in many many cases throughout Canada companies have accumulated depreciation reserves which appear on the surface to be fairly large, but which will suffer substantial reductions as soon as they are able; in some cases they have been able to make replacements which they were not able to make during the war period.

Q. We are looking at it for the future, Mr. Thompson, rather than for some unusual conditions that arose out of the war. Was that the only reason why there was a wide fluctuation in that particular reserve?

A. In the C.P.R. reserve?

Q. No, in the one you mentioned.

A. That was principally because of the inability to make replacements - the one I have in mind.

Q. You would not have that happen during normal times?

A. Yes . . .

Q. In that they would be able to make replacements?

A. Yes, that happens. Take particularly the telephone industry, where an exchange is replaced. That exchange may have been in service 25 years, and can continue to give service; but the business has developed to the point where it is physically unable to give that service, so it is scrapped. The entire investment is scrapped, and sometimes that means writing off an investment of a million dollars, due to growth of the business.

Q. Well, that wouldn't be a situation that <sup>you</sup> would expect to find in a railway company?

MR. EVANS: It was proved to exist in our case, Mr. Brazier.

MR. BRAZIER: Q. Would you expect to find



that in the railway company?

A. I think it could happen quite readily.

Q. I want to return to another subject just for a few minutes, Mr. Thompson. I think Mr. Frawley this morning drew your attention to a statement you made yesterday in your evidence in chief at page 17487. Your second answer on that page reads:

"The governing factor, in my opinion, is whether or not the asset is producing or furnishing transportation service. In that case it should go into rail."

Now by that do you mean that it is exclusively producing or furnishing transportation services?

A. Generally speaking, yes.

Q. If 99 per cent of a company's efforts were in producing and furnishing transportation services, and the other one per cent not . . . ?

A. I think you have to do this: you have to take the facts as they exist, and your opinion will be predicated upon what you find out. I don't think you can deal with it in a purely academic manner or in an abstruse way.

Q. Have you ever examined the accounts and balance sheets of the Canadian Pacific Express Company?

A. I have glanced at them some years ago.

Q. Would you feel that you knew sufficient about them to express the opinion that the C.P.R. were handling that particular matter in the proper way?

A. I would say this: I have listened to the evidence as to how the accounts are dealt with in the C.P.R. books and I have discussed the accounts with





responsible officials of the company, and in my opinion the accounts are being handled in the proper way.

Q. But you are not particularly familiar with the balance sheet?

A. I have seen the balance sheet.

Q. Do you know what percentage of income of the Canadian Pacific Express comes from furnishing transportation services as against other services?

A. No. I cannot answer that; I don't know.

Q. Would you agree that depends a great deal on what the percentage was, whether or not it should be included as rail, as against the other?

A. As I look at the Canadian Pacific Express -- and I think I have given this evidence; and if not, Mr. Liddy has, and I agree with him -- the net revenue from express services is paid to the Canadian Pacific, and appears in the statement of the earnings of the Canadian Pacific.

Q. That is correct.

A. That is in the rail earnings.

Q. That is correct.

A. Now the amount which does not appear, and appears in Other Income, is the revenue arising from financial services. My view is this: that revenue quite properly should go into Other Income and should not appear in rail income. If you took over the primary accounts of the Canadian Pacific Express and added all the expenditures to the rail expenditures of the C.P.R., to my mind you would arrive in the end result at a statement of expenditures which would be confusing. It is part rail; it is part express. And the present method whereby separate statements are prepared giving credit to rail for what is due to rail, to my mind is preferable.



Q. Well now, do you know whether or not the Canadian Pacific Express charges up say against their financial transactions, all proper expenses against that part of doing their business?

A. No, I don't know.

Q. You have been in small express offices of the C.P.R., where they take in an express parcel to be shipped by express, and maybe at the same time decide to buy a money order?

A. Oh, yes, I have.

Q. So in order to get a proper picture you would have to split the cost of those two transactions, one against rail and one against financial transactions?

A. Well, I think that is a question you should ask a railway witness, because I am not sufficiently familiar with the procedure.

Q. What would be your opinion in these circumstances, Mr. Thompson, and I will take the actual figures in Exhibit (49)48 -- Have you that Exhibit there?

A. Yes.

Q. This is one of those sheets out of that two inch bundle Mr. Evans was speaking of this morning. That is the general balance sheet of the Canadian Pacific Express Company, to which is attached the income account. It shows paying express privileges, which is paid to the Canadian Pacific Railway Company, \$7,745,246.96. Is that correct?

A. Yes, that is in the income account.

Q. Yes. What do you think the situation should be if it actually costs the Canadian Pacific Railway Company -- taking a round figure -- \$9 million to carry that express, or something more than what they got out of it?



A. Well, I do not think that the railway can collect from the express company more than the entire revenue of the express company arising from express services.

Q. I make this suggestion to you: Would it be fair, if that circumstance arose, that the Other Income of the Canadian Pacific Express Company should be used to make up the loss on the actual carriage of express?

A. Oh, I do not think so for one moment.

Q. And if there is a loss on that express, then it should just be borne by the other freight shippers?

A. Well, I said they are getting all there is. The Express Company from its revenues deducts its costs, pays the balance over to the railway, and under those circumstances I do not see how the railway can get more, unless of course there is an increase in express rates.

Q. Well, in that particular year there was \$253,000-odd that could have been obtained, wasn't there, from the company itself to help pay for the express services, if there had been a loss?

A. Well, there is Other Income there of \$112,000 upstairs.

Q. I was just looking at the net income figure of the company.

A. The \$253,000?

Q. Yes.

A. Yes. My understanding, of course, is that that largely is from financial operations.

Q. Yes, but it could have been available to pay a loss?

A. Well, I think we have heard the expression around here that the railway has been leaning on Other Income throughout to pay for other services.

Q. There may be some dispute as to that fact, Mr. Thompson. I was just trying to direct your attention to





this particular case. That money was there, and it could have been paid to the railway?

A. It could have been paid to the railway, and if it had been paid to the railway then I think that to the extent it represents income from financial operations it would go into Other Income, and the balance might go into railway income if there was some small balance.

Q. There might have been a loss charged to Other Income?

A. Well, when you say there might have been a loss, I cannot follow that, because, after all, I mean, here is a specific amount of profit, \$253,000.

Q. Are you satisfied that the Canadian Pacific Railway Company probably does not know whether the \$7 million odd actually covers its expenses of handling the express business?

A. I do not know. I cannot answer that question.

Q. That is all, thank you.

MR MACPHERSON: My lord, just a couple of points, and I won't take very long.

CROSS-EXAMINED BY MR MACPHERSON:

Q. Mr. Thompson, are you familiar with a book, Barnes on the Economics of Public Utility Regulation?

A. I have not read it.

THE CHAIRMAN: Barnes on what?

MR MACPHERSON: Barnes on Public Utility Regulation. It was referred to yesterday.

Q. You have not read it?

A. I have not read it, no.

Q. Do you know of it as an authority?

A. Not until I heard about it yesterday.

Q. Now, in this book at page 600 there is a chapter



18 on the regulation of utility expenses. Now, I propose to read just two short paragraphs from it and ask you, Mr. Thompson, from your experience whether you agree with what the learned author has said there. The first paragraph deals with the early attitude toward regulation of expenses, and it says this

"The relation between the operating and related expenses and the charges for the service have been recognized from the beginning of rate regulation. Yet regulation has until recently concentrated on the fair return. Two circumstances were responsible for the relative neglect of operating expenses by regulatory commissions. First, despite early decisions by the Supreme Court recognizing the right of commission enquiry into the propriety of company expenditures, subsequent decisions restrictive of commission authority persuaded many commissions that they could not invade 'managerial fields'. Secondly, the commissions, in common with others concerned with regulation, assumed that the interests of management and consumers in keeping operating expenses at a minimum were identical, and that the judgment of the management with respect to the necessity of operating expenditures might safely be accepted."

Would you agree that that was the attitude?

A. Well, of course, that is a book dealing with the situation in the United States, isn't it?

Q. Yes.

A. And as far as Canada is concerned, and on cases I have been associated with in Canada, the practice has been for the regulatory commission to scrutinize expenses.

Q. Scrutinize expenses?

A. Not make a detailed audit, but by way of illustra-



tion take a statement covering a ten-year period, to see if there were any unusual expenses in the accounts or financial statements of the applicant.

Q. Well, Mr. Thompson, I will give you the second paragraph, and would you say that this in your opinion is or should be the practice before Canadian regulatory commissions:

"THE PRESENT CONCERN ABOUT EXPENSES.

The conventional attitude of easy acceptance of claims regarding operating expenses has undergone a radical change since the middle 1920's when the Federal Trade Commission began its enquiry into the activities of holding companies. It is now quite generally recognized that the operating expenses require as careful and critical scrutiny as the claims for a 'fair return on the fair value of the property'." Would you agree with that principle as one that should be applied in Canada?

A. In other words, that the expenses of the applicant should be examined by the regulatory authority?

Q. I will read that one sentence again.

A. Yes, read the sentence again.

Q. "It is now quite generally recognized that the operating expenses require as careful and critical scrutiny as the claims for a 'fair return on the fair value of the property'."

A. That of course goes a long way, and I think you must bear in mind this, that in most cases large public utilities have their accounts audited---

Q. By whom?

A. By shareholders' auditors in this country.

Q. Yes, but I am talking now of the Commission's audit or check.





A. Well, let me finish what I have to say. And unless there is reason to believe that those audited accounts do not show the facts, in most cases I think they can be accepted, after making shall we say reasonable tests, but not as stringent an examination as would appear to be contemplated in the passage you have just read to me.

Q. That is to say, you would say if they stringently followed the passage that I have just read to you, then you would regard that as an invasion of managerial field?

A. No; I think it would be an unnecessary expense.

Q. An unnecessary expense. And you would say, then, that any public utility company, be it a railway or other public utility company, if it had, as undoubtedly it would have, its own books audited, then the regulatory tribunal should accept the books of the company and the records of the company?

A. No, I did not go that far. What I said was this, that the regulatory authority should make such tests as it deemed necessary. If it found as a result of those tests that in the opinion of its examiners the accounts were correctly stated, I think then it could limit the work which should be done.

Q. Do you know of any tests -- and you have been associated with the Board of Transport rate cases in the past three years -- that the Board of Transport has made into expenses of the company?

A. No, I do not.

Q. You know that in the judgment in the 8% Case there was an indication that there would be tests made, at page 11 of the judgment -- you are familiar with that.

A. Well, we might---

Q. Page 11 of the judgment, Mr. Thompson, at the bottom of the page:



"On the hearing of this application the applicants restated and brought up to date their evidence and exhibits with reference to maintenance costs. I think that these maintenance costs will require further study before any decision can be given, even assuming that the requirements of the Canadian Pacific Railway are to be accepted as the yardstick for a further increase in freight rates."

You remember that?

A. Well, I have read it, yes.

Q. You know of no study they did make?

A. No. I am not running the Board of Transport Commissioners.

Q. I know you are not, but I am only trying to ascertain from you, with your knowledge of the rate cases, whether or not the sort of scrutiny you suggest would be advisable had been conducted by the Board of Transport into maintenance costs of the railways?

A. Not as far as I know.

Q. Not as far as you know. Now, there is just one other question I want to ask you. I cross-examined you before on more than one occasion, Mr. Thompson, in connection with user, and I think your evidence then was that you knew of no railway which had used the user method of depreciation?

A. No Class 1 railway.

Q. No Class 1 railway. I think you also told me that your firm, Peat, Marwick & Mitchell, had offices in many parts of the world?

A. That is correct, yes.

Q. And that you had many railway clients in many parts of the world?

A. Well, particularly in the United States.



Q. Particularly in the United States, but other parts of the world as well?

A. We were auditors, I think, of some of the British railways before the Government nationalized them.

Q. But you know of no Class 1 railway that uses the user theory of depreciation?

A. No; but they haven't an opportunity to do so, because the other method, the straight line method, is prescribed. If they had a free choice the situation might be different.

Q. It might be different; but you have no knowledge that they sought to make it different?

A. Well, I think in the docket 15100 the matter is referred to.

Q. Just?

A. In passing, that the opportunity of making representations, I think it said, is not denied to them.

Q. Now, Mr. Thompson, you qualified your answer to me in saying no Class 1 railway; what did you mean by that? The Sugar Railway?

A. Yes. I did not want to bring in my Sugar Railway.

Q. But I do want to bring it in, for this reason, that you referred before to a Sugar Railway, in Cuba I think it was?

A. Yes, but that railway was run say incidentally to sugar operations.

Q. A sugar estate?

. A sugar estate.

Q. Have you seen these railways, Mr. Thompson?

A. No, I have not.

Q.. How many users do they serve, do you know?

A. Well; they run primarily to take sugar in and out, and to operate on a plantation.





Q. They operate on a plantation, pick up cane and take out raw sugar from the mill; isn't that what they do?

A. I think so, yes. I have not seen them.

Q. There is no regulatory commission that has anything to do with them?

A. No.

Q. And there are no users other than the company?

A. That is correct, yes.

A. And so it is simply, to use a term that was used here this morning, simply ridiculous to suggest that in comparison with the Canadian Pacific Railway when talking about depreciation?

A. Oh, I am not drawing the comparison.

Q. Well, I know, but I just wanted to clear that up. Thank you, Mr. Thompson.

MR EVANS: May I, before my friend goes ahead, give the Commission references to some exhibits where this question of maintenance was gone into by us, because there has been a suggestion left that the Board did not make much of a study:

Exhibit 49-41 dealt with tie renewals.

Exhibit 49-42, new rail laid, all for long periods of time, with accompanying graphs.

Exhibit 49-43, with regard to other track material.

Exhibit 49-44, ballast.

Exhibit 49-45, roadway maintenance.

Exhibit 49-46, track laying and surfacing.

Exhibit 49-52, locomotive repairs.

Exhibit 49-53, freight car repairs.

Exhibit 49-54, passenger car repairs.

Besides that we furnished a large amount of material to the Board that did not go into the record but was used by the Board separately for its own purposes.



MR MACPHERSON: And the result was that the Board said it would make studies, which it did not make.

MR EVANS: The judgment of the Board was this, on page 4 of the interim judgment in 1949, in September -- I am reading from the middle of page 4:

"Dealing first with reference to the Board by Order in Council P.C. 4678, in my opinion no new evidence was furnished the Board or new matters drawn to its attention which would justify disturbing the findings of the Board with respect to the following matters:"

This was on the review of the 21% Case.

"(a) As to the propriety of the maintenance charges submitted by the Canadian National and the Canadian Pacific Railways for rate making purposes."

MR MACPHERSON: I am not questioning, my lord, the first part of that judgment. The 8% judgment deals with a review of the 21% judgment.

MR EVANS: There is no difference.

MR MACPHERSON: The part that I read was at the bottom of page 11 and is in the record, and the Commissioners can read it. Then the final judgment, the final determination of the 20% Case, at page 12, they go on, with respect to the whole question of the interpretation of account rules, which rules are those of the Interstate Commerce Commission and not of this Board.

"It is my opinion that under existing circumstances we cannot say whether or not the railway has in all instances followed the procedure which we might deem the most satisfactory. In the determination of some of the charges there must necessarily be border-line cases where the best judgment of the railway's officers must make the decision."



MR EVANS: Would you care to read on?

MR MACPHERSON: Oh, I can read the whole judgment.

MR COVERT: Let us not have it read.

MR MACPHERSON: I do not think it is needed.

THE CHAIRMAN: Take it as read.

(Page 17620 follows)





EXAMINATION BY MR. COVERT:-

Q. Mr. Thompson, will you turn to page 17478 of the Transcript. I think you say that in the first instance depreciation is just one element of the cost of providing railway services:-

"and I cannot see that any useful purpose would be served by providing any further segregation than is now given in the Company accounts. The amount of depreciation is reflected in the depreciation reserve shown in the Company's balance sheet ".

Then you were asked:-

"When would you say that a company had recovered its depreciation charges from the users of the railway?"

And your answer:-

"I would say that it recovered its depreciation charges from the users of the railway when revenues are such as to provide for all operating expenses, including depreciation, as well as requirements for fixed charges, dividends and a reasonable surplus. Only then, and not until then, in my opinion, will the railway have recovered its depreciation."

Now, does that mean that you regard dividends and a reasonable surplus as operating expenses?

A. I think you have to look on it this way, that you have a regulated utility, and the amount which it is permitted to earn is fixed either by requirements or a rate or return on a reasonable rate base. Now, under those conditions I think you have to consider, first, your costs including



depreciation, operating costs. You must consider the depreciation which would normally form part of those operating costs, and then you have your other items, your fixed charges, dividends and reasonable surplus. I think you have to take the picture as a whole, and if you don't recover any one of those elements, then I don't think you have recovered your depreciation. It is something that you simply haven't got.

Q. And you would include in that same category dividends and reasonable surplus, and you would say that if you had not recovered dividends and reasonable surplus, that you had not recovered your depreciation?

A. Yes, because I think the Company is entitled to recover an amount to pay dividends, an amount which it should set aside as a reasonable surplus.

Q. Would you say that was an accounting concept, Mr. Thompson?

A. I think so. It is my concept.

Q. Do you think you could find any authority that would agree with that statement?

A. Well, I have not looked around particularly.

THE CHAIRMAN: Q. What use would be made of this surplus after you had paid dividends to your mind?

A. What use would be made of the surplus, sir? I think the Company should have something to come and go on. In other words over a period of years to try and achieve an exact balance, would be almost impossible. For that reason I think that any regulated company, in fact any company, should have a certain amount of money set aside by way of surplus, so that it can preserve its financial integrity and function to the advantage of the users of a service which it provides and also for the protection of its shareholders.



Q. Is this surplus then something that should be provided even at the sacrifice of dividends, or would you just consider it after having fixed what you consider to be a proper dividend?

A. I think the dividend should be paid first.

COMMISSIONER ANGUS: Do the surpluses year by year increase the rate base?

A. If re-invested they would have that effect.

MR. COVERT: Q. What puzzles me slightly, Mr. Thompson, is a case like this: that if you had a company which had just earned its operating expenses including depreciation and requirements for fixed charges, but nothing for dividends or, as you suggest, reasonable surplus, you would say that that company had not earned its depreciation?

A. Well, I think I would answer that in that way.

Q. Not recovered its depreciation?

A. That if the company decided to forego dividends and a reasonable surplus and to say: "We will set the amount required for these purposes aside for depreciation purposes" that is the normal thing the company would do; but I think with a regulated utility you should take into consideration the four elements I have mentioned before you can say that the company truly has recovered the amount required for depreciation. You must look at the picture as a whole.

Q. I just didn't know how important the statement was, but it seemed to strike me on the face of it that you included dividends in as operating expenses.

A. No, not at all, but I am talking from the point of view of a regulated utility, to look at the picture from a practical point of view.

Q. Now then, would you turn to the next page, 17480.





Now, in response to the question about safeguards against undue accumulation of depreciation reserves, you made this statement:-

"Yes. Any excess depreciation it may have set aside will be reflected in the depreciation reserve, and when the amount of that reserve is deducted from the investment to arrive at the depreciated investment, the rate base thus determined upon which the rate of return is predicated, will be that much lower."

Now, this safeguard would only operate, wouldn't it, Mr. Thompson, if the Board was fixing rate levels on a rate base as distinct from its past practice of determining requirements?

A. I think that is correct, yes.

Q. And where the Board proceeds on a requirement basis, the safeguard against undue charges for depreciation would presumably be the right of the Board to determine the reasonableness of depreciation charges as outlined in your answer on page 17481?

A. Yes, the Board, as I see it, would periodically review depreciation charges to determine whether they are reasonable or not.

Q. When you say "periodically review", does that mean every year, that it should be every year?

A. My understanding is that the Board in the first place gets railway operating accounts every month, and they get a very elaborate yearly statement, so that the Board are fully aware of net railway earnings from month to month and year to year; and, if in the opinion of the Board at any time the railways were making too much money, then I think



the Board of its own initiative would take steps to keep down earnings to what they thought would be a reasonable level.

Q. I didn't get that. Did you say "would" or "should"?

A. "Would".

Q. Now then, on page 17485 and 17486, Mr. Thompson, there was some discussion as to the treatment of revenues and expenses arising from non-rail activities, and on page 17486 you said this near the top of the page:-

"In my view, statements showing the financial results of railway operations should not include extraneous revenues arising from non-rail operations."

Now, would it not be your view, Mr. Thompson, that the discussions which have arisen as to the inclusion of certain revenue under the heading "rail" arises from the difference of opinion as to what is rail and what is non-rail, rather than from a desire to include non-rail items under the heading of rail?

A. Would you mind repeating that?

Q. Well, the dispute, as I understand it, has arisen as to the inclusion of certain revenue under the heading "rail"; that arises from a difference of opinion as to what is rail and what is non-rail, rather than from a desire to include non-rail items under the heading of rail.

A. I would rather you would split that question. It is kind of a double-barrelled one. Suppose we divide that question into two parts.

Q. Now, there are two questions, <sup>aren't</sup> there: what is rail and what is non-rail?

A. Yes.



Q. And I am suggesting that the discussions that have arisen as to the inclusion of certain revenue under the rail heading, arises more because of a difference of opinion as to what is rail and what is non-rail, rather than from a desire to include non-rail items.

A. Well, it is the last part.

THE CHAIRMAN: The first test would be then: is it rail or non-rail.

MR. COVERT: Yes.

THE CHAIRMAN: As an item.

THE WITNESS: Well, I think that is the first test: is it rail or non-rail.

MR. COVERT: Q. I think you have heard sufficient evidence and read the submissions, Mr. Thompson, to indicate that there is a difference among the two major railways as to what is rail and what is non-rail.

A. That is correct, yes.

Q. And that is the real question then, to determine what is rail and what is non-rail?

A. That is the first question to determine, yes.

Q. Yes, and if it is rail, if the particular operation is a rail operation, would you say that it should be included - -

A. Well, if it classified as rail, I think it would automatically go into rail revenues.

Q. And would it make any difference in your view, whether, for example, that was carried on by the parent company or a subsidiary?

A. I think this, that once you have determined whether it is rail or non-rail, if you say it is rail then to my mind you automatically classify it as rail. You make your





major decision and whatever flows from that would automatically follow.

THE CHAIRMAN: Is there a possibility of the subsidiary itself being non-rail and still carrying on some particular kind of business which is rail? Your question seems to leave that possibility, Mr. Covert.

MR. COVERT: You may have one that is carrying on partly rail and partly non-rail, and if the major portion of it is rail - -

THE CHAIRMAN: Well, let us take the Express Service as an illustration.

MR. COVERT: Yes.

THE CHAIRMAN: Yes, that is one.

THE WITNESS: I think it is better to take something concrete. Therefore, if rail operations are credited with the net operating result profits of the Express Services excluding revenues arising from financial operations, then I think rail is receiving what is coming to it.

MR. COVERT: Q. Just before you leave that, Mr. Thompson, the decision in the case as to what is included or what is taken in as profit, what is charged to expense, all of the decisions with respect to the Canadian Express Company, for instance: who makes those decisions?

A. Well, in the first place I suppose the Express Company is run by the board of directors and general manager and so on.

Q. Has the Board of Transport Commissioners any opportunity to examine the decisions or to test the decisions that are made there?

A. As to the propriety of expenditures?

Q. Yes.



A. My understanding is that if the Canadian Pacific Express Company wish to increase its rates, it would have to justify that increase before the Board of Transport Commissioners.

Q. Yes.

A. So to that extent its operations would be reviewed in the same way that rail operations are reviewed when the railway makes application for an increase in rates.

Q. Now then, your feeling, Mr. Thompson, would be that in cases of that kind, for instance, that would be sufficient protection as far as the freight paying public is concerned in any application that the Canadian Pacific makes for an increase in its freight rates?

A. I think it is automatic protection.

Q. Would you explain that a little?

A. I think this, that the Express rates can only go up if the Board of Transport Commissioners authorizes an increase. Now, the only other thought that occurs to me is this, that if the railway is asking for an increase in rates, there follows the question: should Express rates go up as well? Because the net express revenue is going to go to rail revenue and have some effect on rail results, and I think the Board of Transport Commissioners would be quite justified in looking into that question.

Q. Now, does the Express Company make certain charges against the Railway Company or, vice versa, the Railway Company make certain charges against the Express Company, for services provided?

A. My understanding is that the Express Company pays over to the Railway Company the net revenues arising from Express Services, and these net revenues represent



rail revenues of the carrier. I think if you look at the statement, the Express Company pays its own salaries, keeps up its own trucks, runs its own offices and so on, and charges for this necessary finance. The end result is it makes so much money from these services, and pays that amount of money over to the railway.

THE CHAIRMAN: Are the Express charges fixed by the Board?

MR. EVANS: Yes, sir, under Section 360:-

"All express tolls shall be subject to the approval of the Board".

That is sub-section 1. Then 2 provides for disallowance and so on by the Board.

MR. COVERT: So, in your view, Mr. Thompson, the present manner in which the Canadian Pacific deals with this matter is entirely satisfactory?

A. That is my view.

Q. Now, at page 17487 I think you suggested perhaps a test that would govern whether an item should be classified as rail or non-rail, and you said:-

"The governing factor, in my opinion, is whether or not the asset is producing or furnishing transportation service. In that case it should go into rail".

I just wondered if you meant exactly that. For instance, that would bring in, we will say, trucking.

A. I have no thought that trucking should go in. Quite the reverse.

Q. Perhaps "furnishing rail transportation services" is what you mean. You would not include - -

A. Yes, rail transportation services.





Q. And you would exclude, for instance, bus and truck companies.

A. I think you would have to consider each on its merits. I mean, I cannot conceive at the moment that a bus company should go into rail operations on, say, gross revenues from a bus company and bus expenses. I think it would be preferable to deal with it as a separate entity, but there may be certain conditions where the bus service does form part of the railway service, and in that case it might be desirable, in order to reflect that, to deal with it on a net basis either as a profit or loss on the bus service without bringing in all the subsidiary accounts and confusing the rail accounts by bringing those in.

Q. So that even if a bus company formed an almost integral part of railway operations, you would prefer to see it treated separately and kept out of rail accounts?

A. That is my view, yes, bringing it in on a net basis.

Q. And you would exclude, for instance - or I should say, would you exclude, for instance, electric railways owned by a steam railway company?

A. I find that a little more difficult to answer. That is furnishing a rail service, and my inclination (I may be wrong) my inclination would be that an electric railway would form part of the rail service. After all, you take even the steam railways: in some cases they are partly electrified.



Q. It is that kind of thing that seems to bring out more clearly the difficulty of applying a test of that nature. I mean, it would seem to me that if, for example, one of the businesses of railway is to haul freight, and if they used a trucking company for that -- and it is conceivable that you could use a trucking company - that would be so much a part of that operation that perhaps it should be taken in as a part?

A. I think in those cases you can do as I suggested: you can deal with it on another basis - what is the net profit or loss arising from the trucking operation. If it is a profit, take it into rail revenue, and if a loss, take it into rail expense, as one item, without confusing the railway accounts with all the subsidiary accounts of the trucking company.

Q. In other words, what you really want to do, Mr. Thompson, is/your suggestion would be to have it rail transport only, and not just transport?

A. Rail transport?

Q. That is right.

A. I think that is primary.

THE CHAIRMAN: We will take recess.

----Recess.

----On resuming:

MR. COVERT: Q. Mr. Thompson, before I take up the user method, there is one other point on this business of rail and non-rail. I wondered if you thought the important consideration in a freight rate case, rail revenues and expenses were the real items that were under consideration, and that it was important to have a segregation of rail and non-rail for two reasons: first, because, we will take the case of telegraphs, which come under the Board of Transport

... as I have said, I think that some of the

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Commissioners, and have to be segregated anyway, and similarly with express, if they wanted to raise the rates on express they must be segregated; and in the case of other things like bus and truck, which are not regulated by the Board of Transport Commissioners. . . I was wondering if that was behind your thinking.

A. Whether or not the Board should state which should be rail and which should be non-rail?

Q. Yes; and that was perhaps one of the reasons you suggested this test. You seemed to think that rail transport service is the important item.

A. Yes, I think that, and I think the Board of Transport Commissioners should take into consideration the various factors involved and decide which of the items should be rail and which should be non-rail. That could be done in consultation with the appropriate railway officers.

Q. Now, Mr. Thompson, I want to take up with you a few questions on the matter of the two methods, the user and the straight-line method of depreciation. First, I wanted to ask you if you agreed that in the user method you must have two estimates, and in the straight-line one.

A. Well, I will put it this way: In the case of straight-line there is the factor of value and the factor of time. Now, in the user method the principal factor is use which, shall I say, includes time. I think it is a combination in the case of the user, of taking some unit of use as well as time.

THE CHAIRMAN: Q. Pardon me. Does that mean the user might reduce the time or add to the time, or is time fixed anyhow?





A. No, I think this, sir, that use is the predominant factor.

Q. I beg your pardon?

A. I think use is the dominating factor, and the question of time flows from use. In other words, that with a great deal of use the time element will naturally be less.

Q. That is it; whereas in the other method you first fix your time, then you take your cost and you distribute the use along the time, do you not?

A. That is correct.

Q. But where your time is not constant in the case of an article . . . ?

A. No, because the time would depend on the use to which the equipment was put.

Q. So its lifetime would be longer or shorter according to its use, is that it?

A. That is right.

MR. COVERT: Q. But you don't think that there is that distinction, that in the one case you have two estimates and in the other one?

A. No; in the case of the user I say you have to look at it from the point of view of units of use, which you can translate if you like later into time, but the principal factor is units of use.

Q. But in arriving at that don't you first arrive at the rate for your user method, and with just a straight-line method you have to make an estimate in terms of time?

A. Well, definitely; in straight-line method you make an estimate of time.

Q. Yes.

A. In the case of user you take a locomotive --



Q. But, for instance, you come to the rate, in the first instance, in the user method, don't you? Wouldn't the common practice be to say: "Well now, based on past experience the time over a period of years would be a certain period of time?"

A. No, I don't think it is quite that way. My understanding is this: that you take the estimated mileage which a unit will run, and then assuming an average mileage you relate it to the time in that way.

Q. How would you get that? Would you not have to take the time factor in arriving at the number of miles?

A. There I think your studies will produce the information as to the estimated mileage, which an engineer should be able to tell you. . . the estimated mileage which a piece of equipment will run; it may be a million miles; it is designed to do that.

Q. Is that your understanding?

A. It is my understanding. I have not made an examination of the study, but it appears to me that the dominating factor is units of use.

Q. But take the case of a station, which you depreciate on a user basis?

A. Of course there you are simply taking gross ton miles as your unit of use. It is a method of applying the user basis to, shall we say, <sup>a</sup>certain group of fixed assets instead of using the mileage factor; you use the gross ton factor, but the underlying principles are the same.

Q. But when you take your whole group and apply the user method to that, haven't you taken into consideration the time element on the items of the group that do not perhaps vary with use?



A. We are talking about road, are we?

Q. Yes.

A. Depreciable road?

Q. Yes.

A. Well, I think there again you arrive at the gross-ton-miles which you think represents a factor to be used in determining the lifetime of the facilities; and having arrived at that you then can relate it to time, and you can also look back and see what happened, what experience showed, and you can test it as you go along.

Q. Well tell me this, in working out your user method you do, I suppose, in the first place pick out what you might call an average year?

A. For mileage?

Q. Yes.

A. You test it by that?

Q. Yes.

A. You don't necessarily pick out an average year, and determine your rate.

Q. Or you may take a period of years.

A. You can take a period of years, yes.

Q. That in itself would seem to me to be an estimate or another element taken into the basis for your calculation, which you don't take --

A. Of course you are up against the same thing in straight-line. You have a test in straight-line; if you take 5 per cent rate for 20 years, you may find out at the end of ten years the article or unit is going to last 30 years, and you would adjust your rate. It is done every day.

Q. I want to come to that. How often are the rates





adjusted in an ordinary business?

A. In an ordinary business depreciation rates are largely predicated upon income tax practice. The taxpayer usually takes as much as the Department will allow. In the case, however, of a utility, and particularly a regulated utility -- I have one in mind where by an actual study the rate was set say in 1934 or thereabouts -- I will give you approximate figures -- say at five and a half per cent composite rate, and was changed ten years later to 4.60 per cent because it was found that the assets were lasting longer than had originally been planned.

Q. Is it your experience, Mr. Thompson -- you have mentioned one case -- in the case utilities generally that the depreciation rate on the straight-line basis is changed very often?

A. Well, it depends on what you mean by very often. It is not changed every year. I would say, as a guess, probably it is reviewed every ten years, not less than every ten years.

Q. Now if the user method were adopted by railways you would think then that the rate should be tested periodically? I think that is what you said?

A. Yes.

Q. Now when you use the word "periodically" do you mean something like every ten years or perhaps something oftener?

A. I would say <sup>1</sup> my own preference would be, say, some time after the lapse of seven years. . . . seven to ten years.

Q. Now Mr. Thompson, <sup>do</sup> you think that policing



the user method would be any problem? Do you think it would present any serious problem to the Board of Transport Commissioners, or its staff, if it were adopted by the railways in Canada?

A. No, I don't see any problem there.

Q. Would the problem be any more difficult in the case of user method than the straight-line method?

A. No.

Q. Not at all.

A. No.

Q. Do you say that because there are really only two large railways? Is that the reason?

A. No; I think that helps, naturally. We only have two railways, whereas in the United States they have a very large number of railways; but I think it would be a comparatively simple matter for the Board of Transport Commissioners to examine the under-lying principles of the user method, and do it without any difficulty.

Q. There is no difficulty, in your opinion, about understanding how the growth trend works or how the survivor curve works?

A. I think the staff of the Board of Transport Commissioners could follow that without any difficulty.

Q. Now, you are favourable to the user method?

A. Definitely.

Q. For railways?

A. Yes.

Q. Is the main reason that you favour it this business of it being treated as an expense that fluctuates with use, and is therefore likely to fluctuate with revenue?



A. Well I think, as I said before, to my mind it is particularly applicable to railways; it is realistic; it goes up and down with traffic, and it charges against expense, in a normal equitable way, the expense of depreciation <sup>more so</sup> /than I think the straight-line method does, which is slightly more rigid, or which is rigid.

Q. You would feel, Mr. Thompson, that that method should be available to the railways?

A. That is my view.

Q. At pages 17500 to 17501 you seem to lay considerable stress on the difference between the words "fix" and "approve" as applying both to I think method and also the rate. I just wondered if we could get a further explanation on that from you, Mr. Thompson?

A. My view is this, that the railway should have the option of deciding which of the two methods it chooses to adopt, and then that method can be submitted to the Board of Transport Commissioners for approval. I think that the choice of the method should lie first with the railway company; in other words, I don't think the Board of Transport Commissioners should say to a railway company you shall do so and so. My view is that the railway should have the option and then defend, shall we say, its method before the Board. It is a question of procedure very largely.

THE CHAIRMAN: Q. That will not interfere with uniformity of accounting, that is if the two railways choose different methods?

A. If they choose two different methods, to that extent there won't be uniformity.

Q. You think it is a sacrifice which might well be made against uniformity?





A. Yes, I would think so.

MR. COVERT: Q. And as long as the railways were on depreciation accounting, if the Board decided what assets must be on that basis, and if the two methods, the user and the straight-line, were available to the railways, and one was on straight-line and one on user, would that present much difficulty in comparing the results of the two railways?

A. No, I don't think so, because I think the main thing is both railways should depreciate the same assets.

Q. That in your view, Mr. Thompson, is the important thing as far as uniform accounting is concerned?

A. Yes.

Q. That is with respect to depreciation?

A. Yes.

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(Page 17639 follows)



Q. As long as that were done, then the difficulty by one using the two methods, that would not be the same at all as the case where one was we will say on retirement accounting and the other on depreciation accounting?

A. Well, on that, I think the view was, my view, first that the same assets should be depreciated.

Q. That is right.

A. Second, if one was on user and the other was on straight line, would it be easy shall we say to see what would happen and compare the two?

Q. That is right.

A. I do not think there would be any difficulty.

Q. One of the difficulties in the past has been that, although the two roads may have been on depreciation accounting as far as some assets were concerned -- that is, like equipment -- they were not on the same basis as far as the remaining assets were concerned?

A. Yes, and that is correct.

Q. And is that what presents the real difficulty in comparison?

A. Today, yes, very largely, I think so.

Q. Now, there was one point -- I think it was in connection with an answer you gave to Mr. Evans about some evidence of Mr. Morrison, and I think the record was not cleared up. I do not know whether that was cleared up this morning or not. Did you clear it up, Mr. Frawley?

MR FRAWLEY: No, I don't go back into that. I thought it was cleared yesterday.

MR COVERT: Well, it seemed to me that it had not been, and I just wanted to make sure of that.

Q. Mr. Morrison at page 14442 said this:

" . . . Alberta submits that in the case of Fixed Charges there must be an allocation and apportionment



between Rail and Non-Rail and in the case of Dividends an apportionment."

You were asked if you agreed with that, and you said, "No, I do not agree with that submission." Then the matter was later discussed, and I think it was pointed out that Mr. Morrison made that statement on the basis that it was dealing with requirements, and I wondered if that would change your answer any, Mr. Thompson?

A. No, it would not change my answer.

Q. It would not change your answer at all?

A. No.

Q. Thank you.

MR EVANS: There is no re-examination, my lord. I will call Mr. Newman.

COMMISSIONER ANGUS: Q. Mr. Thompson, might I ask just one question first? Do you think that the railways in Canada are strictly comparable with other regulated utilities?

A. Such as telephone companies and power companies?

Q. Yes; I think you have had experience.

A. No, I do not think they are strictly comparable. I think today in Canada, with respect to public utilities controlled in the several provinces, there is greater supervision exercised by the regulatory authorities.

Q. Do you think that the greater variability of income from year to year makes a difference?

A. It may have some bearing.

Q. Do you think that the railways were shall we say regulated utilities forty years ago, or have they become so?

A. Do I think they were forty years ago?

Q. Yes.

A. Probably Mr. Evans -- I am not sure just when the Board of Transport Commissioners Act was passed. It was early in the century.





MR O'DONNELL: 1903.

THE WITNESS: 1903, I understand.

COMMISSIONER ANGUS: Q. I mean, do you look on them as speculative enterprises that have become public utilities, or as enterprises that should be considered as public utilities from their inception?

A. Well, I would hardly look upon a railway as a speculative enterprise. Naturally there has been growth and development, and we have passed through several railway booms, and over the years greater attention has been paid to the railways by public authorities, particularly the Board of Transport Commissioners; an increasing interest is shown.

Q. And if income varies a great deal from year to year with business conditions, do you think that in fixing a rate to correspond to a rate base the regulatory authority must label its year as an average year or a fat year or a lean year?

A. No, I do not think that, because if the regulatory authority allows some margin, a reasonable surplus, then I think if a railway runs into a period of two or three years where it is not making money it has something to come and go on.

Q. And you think that the difference between the years will reflect itself mainly in the size of the surplus in each year?

A. Yes, in the final surplus in the books, which probably will move up and move down without disturbing railway rates every year, to take care of what might be a temporary situation.

Q. But in allowing a surplus, it is a rate of return that sets it, isn't it?

A. Yes; the rate of return normally should be sufficient



to provide for a reasonable surplus, and that is definitely predicated on the rate of return.

Q. Well, that would have the effect of treating the year in which the rate was fixed as fat, lean or average; you would merely have to look at the surplus in that year?

A. Well, of course, there is this, that, whatever year is selected, the Board of Transport Commissioners would necessarily look to future years to see how it was working out. It is their privilege to initiate proceedings. If the base year was say too profitable, they would then take steps, I would judge, to reduce the return to the railway, and, conversely, if the base year selected was a poor year, then steps would have to be taken to increase the return to the railway.

Q. But you think that changes in this surplus from year to year could avoid frequent revisions? You see, after all, the rate base changes if there is a big change in investment rates or a big change in depreciation.

A. That would depend on economic conditions generally, I think. It is difficult to conceive the exact situation which would necessitate an application. It would depend on business conditions generally, economic conditions generally.

MR FRAWLEY: My lord, before Mr. Evans goes, and while Mr. Thompson is still in the box, in view of the amazing situation in which the matter of Mr. Thompson's opinion yesterday given has now been left, I would like to call the Board's attention to what happened yesterday afternoon, after I objected and pointed out that Mr. Morrison had predicated his statement, that fixed charges and dividends must be apportioned, upon the premise that the railway is going to the Board on the basis of requirement. Then my friend said, at page 17476:



"MR EVANS: There is really nothing between us. Then I understand --

THE CHAIRMAN: Except the foundation."

Then a little later on:

"MR EVANS: Yes. I do not want to prpursue it."  
Then he said this:

"MR EVANS: I had only one question to ask about that. I got the witness' view that he disagreed. He said if a rate of return were given this apportionment was not necessary. That is all he said." Now, that is how it was left yesterday, and I left it there. Now Mr. Thompson today says, "I really meant, and if I had been given an opportunity I would have said, that I disagree with Mr. Morrison's submission, that in the case of fixed charges there must be an allocation and apportionment between rail and non-rail and in the case of dividends an apportionment."

Q. Now, you say, Mr. Thompson, that even when the company goes to the Board on the basis of requirements, there should be no apportionment of fixed charges or dividends between rail and non-rail?

A. Yes, I say that.

Q. And you were saying that right in the face of what the Governor in Council said on the appeal from the 21% Case, and in the---

MR EVANS: Well---

MR FRAWLEY: May I finish my question, please?

MR EVANS: You had an opportunity of cross-examining.

MR FRAWLEY: I explained why---

MR EVANS: And here you are putting to Mr. Thompson an argument.

MR FRAWLEY: I explained why I had to rise again





this afternoon.

THE CHAIRMAN: We will let Mr. Frawley go on.

MR FRAWLEY: Q. So I say, Mr. Thompson, you are saying that now in the face of the judgment of the Governor in Council in P.C. 4678, disposing of the appeal in the 21% Case?

A. Yes, I am.

Q. And in the face of what the Board itself did when they apportioned fixed charges?

A. Yes.

MR FRAWLEY: So now I simply want at this place, so it will not be too far away in the record <sup>to</sup> read into the record what the Governor in Council said about the apportionment of fixed charges and dividends, in P.C. 4678, dated the 12th of October, 1948.

MR EVANS: You better read the whole Order in Council.

MR FRAWLEY: You will read what I do not read, if the Commission will allow you to.

"The Committee are favourably impressed with the view that income derived by the Railways from sources other than their railway transportation operations should not be entirely excluded by the Board in determining the corporate needs of the Railways. The payment of fixed charges and income taxes are corporate obligations of corporations as such, and the incomes of corporations, whatsoever their source, are liable therefor; provisions to be made for dividends and a surplus are likewise corporate needs and should be so considered. For these reasons, the Committee are of the opinion that some portion of the corporate needs should be borne by the income derived from non-railway operations.



The Committee are further of the opinion that an investigation should be made by the Board in order to determine the apportionment to be made, between railway earnings and other income, of fixed charges, depreciation, income taxes, dividends and surplus, . . ."

That is all I want to say. I just wanted to have the matter straight as far as I am concerned.

MR EVANS: All I want to point out to the Commission is that throughout the Order in Council---

THE CHAIRMAN: Pardon me. Did you say you had a question on that to Mr. Thompson?

MR FRAWLEY: No. I got from Mr. Thompson now that he is of that opinion, in the face of this judgment.

THE CHAIRMAN: Then you are through with Mr. Thompson?

MR FRAWLEY: Yes, I am finished.

THE CHAIRMAN: Thank you, Mr. Thompson.

MR EVANS: I just want to say this about what my friend Mr. Frawley said: The Order in Council was the subject of a very considerable amount of argument. The Commission will have observed that the portion read by Mr. Frawley spoke of "corporate needs", and did not in any way speak of what would be a reasonable dividend for the railway to pay. If it was corporate needs we were talking about, that is one thing, but what we are discussing here is railway needs.

The point I made through Mr. Morrison out of Mr. Morrison's evidence was that when Mr. Morrison was in chief he said there must be an apportionment. Now, I think there is a vast distinction. Unless you can establish that what you are apportioning are corporate needs, then there is no need for an apportionment, and I say the way you test whether it is fair or not is, you test it in relation to investment.



There is a very great deal of discussion of that in the 20% Case, and Mr. Carson argued that, beginning at page 3855 of the transcript in that case. It goes on for some considerable distance. One of the points raised was whether the Governor in Council had the right to direct the Board to make an apportionment, and we took the position that if it amounted to that, then it was beyond the Governor in Council's power, because the Governor in Council under the Railway Act has only the power to vary or rescind an order of the Board. However, I do not want to renew all that old discussion.

THE CHAIRMAN: Well, I thought myself, when I heard Mr. Frawley reading, that that portion of the decision of the Government was something I would like to hear again. We will let it go for the present, but we will come back to it.

MR EVANS: Well, there is a good day's argument on that question if we go into it.

THE CHAIRMAN: I suppose Mr. Frawley intends at some time to ask us to do something about it; don't you?

MR FRAWLEY: About the apportionment of fixed charges and dividends?

THE CHAIRMAN: Yes.

MR FRAWLEY: Well, we are all right. We have got our fixed charges apportioned now. We are still looking for the apportionment of dividends. I don't know whether this is the forum or not.

THE CHAIRMAN: Yes, but you have been bringing it here. I do not know why you brought it here unless you thought this was some kind of forum -- not only a sounding board, you know.

MR FRAWLEY: I put it into the submission of Alberta on financial matters, yes, sir, because I thought it was a proper matter to bring to the Commission's attention.





THE CHAIRMAN: Well, all right, Mr. Evans. You have another witness?

MR EVANS: Mr. Newman.

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WILLIAM ARTHUR NEWMAN, called.

EXAMINED BY MR EVANS:

Q. Mr. Newman, you are at the present time occupying two positions in the Canadian Pacific, one the Manager of the Department of Research, and the other Chief of Motive Power and Rolling Stock?

A. Yes, sir.

Q. And I understand that you were graduated in 1911 from Queens University with the degree of Bachelor of Science in Mechanical Engineering?

A. That is correct.

Q. And that you joined the Canadian Pacific in July of 1911 as a special machinist apprentice; am I correct?

A. That is right.

Q. And you occupied variously throughout your career the position of draftsman, supervisor of betterments, assistant mechanical engineer, engineer of locomotive construction in the Mechanical Department, engineer of locomotive and car construction in the Department of the Chief Mechanical Engineer, and that on February 15, 1923, you became Mechanical Engineer of the Company, and on September 1, 1928, you became Chief Mechanical Engineer?

A. That is right.

Q. Then on December 1, 1940, you became a director of Federal Aircraft Limited, on loan from the company to the wartime services of the Government; is that right?

A. Correct.

Q. Then on January 14, 1941, you became Managing



Director of Federal Aircraft Limited?

A. Correct.

Q. And in September of 1942 President and General Manager of Federal Aircraft Limited?

A. Correct.

Q. Then on October 1, 1944, Aircraft Comptroller of Canada?

A. Right.

Q. Then on February 1, 1945, on your return to the company's service, you were appointed Manager of the Department of Research?

A. That is correct.

Q. A position which you still hold. And then on June 1, 1949, you also took over the position of Chief of Motive Power and Rolling Stock for the Company?

A. Right.

Q. Now, Mr. Newman---

THE CHAIRMAN: Well, you have qualified Mr. Newman. We will continue in the morning.

---The Commission adjourned at 4:45 p.m., to meet again at 10:30 a.m. on Friday, March 10, 1950.



ROYAL COMMISSION  
ON  
TRANSPORTATION

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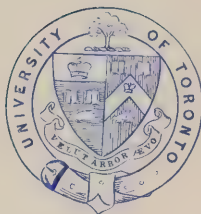
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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO,  
FRIDAY,  
MARCH 10, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN  
HAROLD ADAMS INNIS - COMMISSIONER  
HENRY FORBES ANGUS - COMMISSIONER

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G.R. Hunter  
Secretary

P.L. Belcourt  
Asst. Secretary

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M.A. MacPherson, K.C.	}	Province of Saskatchewan
J.J. Frawley, K.C.		
F.D. Smith, K.C.	}	Province of Nova Scotia; Transportation Commission of the Maritime Board of Trade
J. Paul Barry	}	Province of New Brunswick
C.W. Brazier		
F.R. Hume	}	Province of British Columbia
M.L. Rapoport		
	}	Canadian Automotive Transportation Association

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Ottawa, Ontario,  
Friday, March 10, 1950.

M O R N I N G   S E S S I O N

---The Commission resumed at 10.30 a.m.

THE CHAIRMAN: All right, Mr. Evans.

WILLIAM ARTHUR NEWMAN - Recalled

EXAMINATION BY MR. EVANS - Resumed:-

Q. Now, Mr. Newman, I want to introduce the first subject by recalling the Commission's mind to the evidence of Mr. Crump. At page 13961, Mr. Crump read a portion of Part I of the Canadian Pacific Brief at page 10 where it said:-

"Canadian Pacific is confronted with the necessity for securing substantial amounts of new capital".

He went on at page 13692 to elaborate on the need for modernizing existing facilities and securing what he called new tools and that sort of thing.

Now, at page 13710 he read further from the Brief at page 10, pointing out that the Company must be assured of a level of rates that would afford it a fair measure of net earnings each year in order that its credit position may be restored. In that way, he said, it could then secure the capital funds required.

Now, in Mr. Crump's evidence reference was also made to the program of capital expenditures, which he dealt with in his evidence, and also, Mr. Newman, in your evidence in the 20 Per cent Case. It was stated at page 13711 in reference to Part II of the Brief, that you, Mr. Newman, had pointed out in the 20 Per cent Case that it could not





be expected that economies from improvements would be fully effective immediately, but that, subject to the reservations referred to in the Brief, an estimate had nevertheless been made. I understand you made that estimate.

A. I was in charge of the making of the estimate.

Q. Yes, then we pointed out at that stage of Mr. Crump's examination at page 13711, that you, Mr. Newman, would give evidence as to the details of the estimate and the basis of the estimate of economies, because you had made or had been in charge of the study. Now, with that summary of what introduces this subject for your evidence, would you turn to the Brief, Part I, and begin by reading the third paragraph on page 11 and then read down to and including most of page 14 and excepting the last seven lines. Begin about that paragraph in the middle of the page, Mr. Newman.

A. It must be borne in mind that the entire program amounting to about \$400,000,000 over a five year period is by no means all likely to produce operating savings. For example, the purchase of equipment consisting of freight cars and passenger cars to restore worn out work capacity and to meet expanding national requirements upon which no operating savings can be seen, amounts to slightly more than \$195,000,000. By restoration of work capacity is meant the purchase of sufficient equipment to maintain the capacity of the equipment wearing out from time to time and which must be replaced during the period. By expanding national requirement is meant the growth in total capacity required to meet the increased traffic due to population growth which was referred to by me in my evidence in the 20% Case.

It therefore follows that approximately one-half of the total capital required in the five-year program referred to is not such as to contribute anything to savings.



COMMISSIONER ANGUS: Mr. Newman, would that mean it might contribute to greater earnings which would not otherwise be made?

A. That is taken into account in our resumé to which I will speak later on, where we do show that the expanding national requirement which is included in this amount does produce additional traffic which, it is counted on,

will at least carry the expense required for the equipment necessary to handle the increased traffic. Does that answer your question, sir?

Q. Yes, it does, except that the \$195 million on which no operating savings can be seen, might, as far as I can see, be earning its keep by meeting extra traffic, except insofar as it was restoring worn out capacity. It seems to me there is a difference between restoring worn out capacity and meeting existing requirements.

A. Well, there are two parts to the equipment program. The first is merely to restore the capacity that we lose each year by the wearing out of the tools. In other words, each year that we operate we wear out equipment, and all we ask is that at the end of the year we enter into the next year with the same work capacity that we entered the year. That of course is merely replacement of tools to handle the going volume of traffic. Then the next part of it is additional tools or additional equipment to handle the nation's increased traffic due to expansion in population.

Q. Should the \$195 million be sub-divided - -

A. It is sub-divided later on in my estimates, and when we come to it I will try and remember to point out just what that division is.



MR. EVANS: Q. Then if you don't, Mr. Newman, I will try and remember to point it out to you.

A. The position with regard to locomotives is however, different. The purchase of locomotives although they may be merely for the purpose of restoring work capacity and for meeting expanding national requirements will produce savings because of new and more efficient types now available. In my evidence at page 1470 in the 20% Case/<sup>I</sup>stated ~~my~~ view to be that it was unlikely that Canadian Pacific would buy any more steam locomotives, because of the more efficient diesel locomotives now becoming available.

(Page 17654 follows)





In the result, the program for locomotives involves a program of dieselization and because of the change from the steam locomotive to the diesel locomotive an investment of slightly more than \$68,000,000 over the next five years would probably produce, after completion of the program, slightly more than \$12,000,000 per annum of gross operating savings.

I think that to some extent clears up some of things in your mind, sir, but I will again refer to it.

In the case of road property the position is somewhat different. The program involving road property consists of the expenditure of approximately \$136,000,000 over the next five years. Of this some \$40,000,000 can be classed as ordinary improvements and the balance of approximately \$96,000,000 may be classed as extraordinary road property improvements consisting of new and improved terminals, heavier rail and the like. With regard to these, it is difficult to estimate what the savings will be but it is known that over a long term they would be substantial. Canadian Pacific estimates roughly that the gross savings to be achieved from this class of expenditure may be expected to approximate something more than \$13,000,000 per year.

Thus the gross savings from equipment and road property involved in the program put forward by Mr. Crump and Mr. Newman will, it is estimated, be something more than \$25,000,000 per year. This amount of gross savings would be realized only in the sixth year of the plan, that is, upon completion of five years of the program. In earlier years, the savings would be much less, not only because the total capital expenditures from which they are derived would be less, but also because there would be a considerable time lag between the making



of expenditures and realization of economies from them.

However, these savings are offset in several ways by additional expenses.

The additional expenses involve primarily three general groupings. First, interest charges on the additional investment, which for the purpose of the estimate are taken at 4 per cent on equipment (due to the ability to finance equipment on a lower basis than other borrowings) and 5 per cent on road property. The total program would involve additional interest charges of approximately \$11,000,000 per annum. It will be noted from the statements appearing in the Appendix at pages 36 and 37, that no charge has been made to operating expenses for interest and depreciation charges in respect of capital expenditures in regard to equipment, attributable to restoration of work capacity and expanding national requirements. In the case of expanding national requirements this is because it has been assumed that increased traffic will result, which will take care of the interest and depreciation charges. In the case of the restoration of work capacity, no interest or depreciation charges have been made to the extent of the capital required up to the original cost of the property replaced. Interest and depreciation charges, however, have been made in respect of capital required to meet cost in excess of the original cost.

MR. EVANS: Q. Just before you go on, in that sentence commencing: "In the case of expanding national requirements . . ." it is said there that it has been assumed that increased traffic would result, and that that would take care of interest and depreciation charges on capital expenditures. I was wondering whether Dr. Angus felt that that was in part an answer to the question



that he asked.

COMMISSIONER ANGUS: Yes. I was really considering the distinction which was presumably made at pages 36 and 37 of the appendix between those two amounts.

MR. EVANS: Yes. I am going to ask Mr. Newman to go through those tables.

Q. Go ahead, Mr. Newman, if you will.

A. However, in regard to road property, since it is impossible to distinguish between the capital expenditures attributable to the restoration of work capacity and expanding national requirements, the charge to operating expenses for interest and depreciation is included for the total amount of the capital expenditures and these are to some extent offset by savings which had not been calculated in regard to the same expenditures for equipment.

Mr. Evans, this next sentence in my opinion is not clear. May I substitute another sentence for it?

Q. Yes.

A. To some extent these total charges to operating expenses are offset by earnings from the portion of expenditures on road property that are required for expanding national requirements. No segregation of such earnings has been made for road property, as was done for equipment.

That merely expands it.

Q. You think that is clearer than the balance of the sentence?

A. It may expand it. The meaning is there, but a little difficult to grasp.

Q. Yes. Will you proceed?

A. Second, additional charges to expenses result from the fact that with an increased inventory of depreciable property, the depreciation accruals would have to be increased. These additional charges for both road property and equipment

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would, it is estimated, amount to approximately \$3,000,000 per annum at the end of the five-year period. For the purpose of the estimate, the increase in depreciation accruals was calculated on an amortization basis using the same rates of interest as were used in calculating the increase in the interest charges.

After deducting increases in expenses due to interest and amortization charges from the gross operating savings, the annual net savings after completion of the program would be something more than \$11,000,000.

In the third category, the carrying out of the program would involve, in addition to the capital expenditures, charges to operating expenses amounting to about \$10,000,000 annually to cover the cost of replacement of non-depreciable property (mostly rail and ballast) and incidental charges.

Q. Before you leave that point, the non-depreciable property referred to there, would that for example, include such things as rail?

A. It is mostly rail, other track material and ballast.

Q. We have had evidence here that the rail and those other elements in the track structure are on the renewal accounting basis. Am I correct in saying that the intention of that programme is to indicate that these charges to expense result from the application of renewal accounting to those particular kinds of property.

A. That is correct.

Q. Now, will you proceed?

A. Since rail and other track material are classed as non-depreciable road property and are maintained currently by charges to operating expenses on a renewal accounting basis, the replacement of these materials in



kind would involve a charge to expenses and it is only the increased cost due to the increased weight of rail or improved materials which would be treated as a capital expenditure. It is estimated that this third category of costs chargeable to operating expenses in connection with the capital expenditure programme, would amount to about \$10,000,000 per annum throughout the five-year period.

Q. Well, in the course of Mr. Crump's examination, Mr. Carson drew attention to the appendix at pages 28 to 37, where there is a memorandum indicating the nature of the programme.

MR. EVANS: It is the appendix to Part I, my lord.

Q. And at that time Mr. Carson pointed out to the Commission that the nature of this programme would be explained by you, Mr. Newman. Now, without reading from that section of the brief, which the Commission has probably read at least in part, would you care to give something in general terms about the nature of that programme?

A. My lord, I will refer to the tables, and go over them and explain them in a general way.

The kind of things that are contemplated in this programme have been referred to by previous witnesses -- I mean Mr. Crump -- and are given in some detail in the written part of Appendix I preceding these two tables. However, if you are to understand why this programme has been prepared and the position that the railways find themselves in, I would like to first give you just a little background so that you will be able to follow me when I come to explain the table covering the programme in its general terms.

As a first definition I would like to make this statement, that the history of the railways has



completed its first volume. Volume I is closed. It is brief<sup>ly</sup>/the history of railways during the period when they had a monopoly of all land transport. We now find ourselves in the early chapters of Volume II, where we find ourselves not only in competition with a well-established and rapidly growing highway transport system, but also in competition with aviation, not only in passenger traffic, because those of you who have followed closely with the air companies, their plans and prospects, will realize that in the course of a few years they expect that air cargo transport will greatly exceed air passenger transport. So that we are facing not only one form of land transport competition, but two.

In addition to this we are being severely conditioned by economic changes just the same as is all industry and commerce. We not only have to maintain the rise in labour and material prices, but we have to serve industry which in itself is being probably more severely conditioned than the railways; and the cost of raw material and the cost of processing all means that they cannot afford to have large sums of money tied up in raw material or material in process. So that the standards of service that are required from the railway, and from all forms of transport, is reliable, fast transport service that will result in the minimum of materials and the minimum of capital tied up in the materials and goods flowing through manufacturing plants on their way to the ultimate consumer.

Now the crux of the matter with us is that in 1929, for example, the average cost of our freight equipment then was \$3400 per car; the next large programme, 1937, was \$3600 per car; and the average cost of the next







big programme, in 1947, was \$9400 per car. Now if the costs are not to rise with the railway, and if we are to be able to maintain the position that we have always held, of giving the Canadian nation the lowest cost of freight transport in the world, we have got to find ways and means of lowering our costs, and this programme is pointed only to one thing, to be able to lower our cost.

The first thing we must face is how to get more work out of expensive equipment. We cannot face having cars standing around that cost on an average of \$9400. And unfortunately, sir, we are rather helpless to a very great extent, because 43 per cent of the calendar time of our freight equipment is not under the control of the railway, but is under the control of the shipper or consignee in loading and unloading. That is 43 per cent of the calendar time.

Q. So that, Mr. Newman, you mean that the shipper will order a car from you, and you switch in a car or a series of cars to his siding. . .?

A. From the time that we get his demand for a car and a car is put into his siding, until we pull it out again, the total time that that equipment is outside of our ability to control it is 43 per cent of the calendar time.

Q. Yes. I am sorry to have interrupted you.

A. Now, all that we have left to work with is 57 per cent of the calendar time; and in analyzing that we have got to see how we can get considerably increased utilization out of our equipment. There are only two ways to do it. I will amend that, and say there are three ways to do it. First, keep it under repair less time -- which is the minor part of it; second, get it over the road faster, which is important; then third,



use terminals to expedite the movement of trains and cars through rather than to delay them, which is the fact at the present time, as our terminals were never built to meet the modern requirements for rapid transport.

Q. Is that the kind of thing that is represented by Mr. Crump's description of a unit yard?

A. That is the first thing we have done to meet that requirement. 40 per cent of the calendar time our equipment spends going through terminals.

Q. Is that added to the 43 per cent of time?

A. That is added.

Q. Added to the 43 per cent?

A. Actually an analysis of it runs like this: I will give you round percentages and I may be one per cent out. Five per cent for repair -- actually it is 5.3 per cent;  $11\frac{1}{2}$  per cent of calendar time wheels move; 40 per cent of time going through terminals; 43 per cent of time in the hands of shipper or consignee.

Q. Now, you have just said there were three things you could do.

A. Improvement of maintenance, so that there will be less time under repair; and we have little to go on there, as it is only five per cent of the time spent in that category;  $11\frac{1}{2}$  per cent -- this is the complete time -- to expedite trains over the road; but the biggest to my mind, the one I attach the most importance to, is the reconstruction of our terminals to some degree from coast to coast.

Q. That is to improve the terminals; to improve your motive power . . . I suppose that is involved in part in this programme.

A. Yes; there are other things, but I am merely



saying it is my principal point that we must improve our utilization. Those are things we can work on improving utilization.

Q. What have you to say as to whether this programme in itself could accomplish all that you seek?

A. This programme will not accomplish all of it; and this should really not be referred to as a programme. The Canadian Pacific has never been static. Every year we have had expenditures on capital account to some extent; some years large, some years small. We have even gone, I would say, in periods. Some periods, like during the depression, expenditures were very small. In the war, and perhaps it is a coincidence, but the ten years after the first world war we had a burden of capitalization spent, or capital spending, that if we hadn't had it we would never have got through the depression, nor would we ever have got through this last war. It was the large amount of spending that was done over the five or six year period that gave us sufficient sinues to go through the twenty years of very severe conditioning that we have experienced during the depression and the war.

Now, this starts off and says a \$400 million programme, and it looks very large; but it is no larger than it has been in the past. This \$400 million today was only \$200 million in the twenties. In other words, when I quote the ratio expense for a freight car as three times today what it was in 1929, you realize I am quite conservative when I say for the dollar we are spending today we would only have to spend 50 cents to get the same results in 1929; and for the five consecutive years in the ten year period





after the first world war we spent \$40 million a year; one year we spent \$70 million; and four times five is \$200 million, and multiply that by two, it is \$400 million today. So that in this next five-year period we envisage the same kind of economic requirements that existed and had to be faced in the first ten years after the first world war.

THE CHAIRMAN: Q. Pardon me, but will not your terminal renewals add considerably to the \$400 million?

A. No, they are included in that.

Q. All included in that?

A. They are included. We cannot begin to do these terminals quickly. It has taken us over three years on the Montreal terminal and it won't go into operation until July 1st of this year. There are 80 miles of track in that terminal. The facilities that are created there are absolutely outstanding, and if you Commissioners could spare the time to see that unit yard I am quite sure you would get a far better appreciation of the things the railway is facing than my merely trying to describe it to you in words.

This programme, and again I would like to emphasize this point before I start to talk about it in detail, this is isn't a programme that was prepared for the rate case or for this Commission. This had its roots in the review work of my department in trying to pull together and inform our company of the kind of things that had to be done if the Canadian Pacific was to live up to its motto of



"maintain the property." And the occasion of the 20 per cent rate case was considered as one where we should point out to the proper bodies and to the public the magnitude of the things the railways have to face to serve the nation.

And now, I think I have referred to it in a general way, Mr. Evans, and unless you have some questions you want to ask me to develop that further, I can turn to the summary of the programme.

Q. I would be glad if you would, unless the Commissioners have some questions. Perhaps you could turn them to those . . . Do you want to turn to the tables now? Is that your desire?

A. Yes, I was to speak about the tables.

Q. Yes.

A. The first table which is at page 36 of Appendix I.

Q. That is:

"Gross capital expenditures for the equipment programme at the end of the first five-year period and the gross and net savings as of the year 1955."

Now perhaps I could ask you a few questions about that. You have said in your evidence that restorations of work capacity represented merely the making good of that which you lose through use in the service of the railway, and you described something which, I think, you called expanding national requirement. Now before you deal with this table in detail, perhaps you would like to say a word to the Commission about what you mean by expanding national requirements, and how you go about estimating what that



may mean to the company?

A. This table covering the gross expenditures for equipment in the five-year period is based upon what we call the normal expectancy of traffic - not on to-day's volume, not at the low level, but, if you like, the average levels, because to bring equipment in any other way would require too heavy an investment to meet peak periods.

Q. What do you aim at? You say you buy this equipment for average levels of traffic?

A. That is correct.

Q. And then you have got to take care of both peaks and depressions. Now how does your principle operate between the two?

(Page 17668 follows)





A. The principle operates in this way, that when you have high volumes it is easier to get high utilization, therefore you get more work out of the same units, and we have always found in the past, as witness war conditions, that we have been able to carry absolute peak traffic, with a lot of difficulty, but with equipment that was built for peacetime conditions; so if we supply the nation for average normal traffic requirements in peacetimes, the high utilization possible in periods of high traffic enables us to do such things as we cannot do normally. Then at the same time if traffic falls off to a depressed level, of course we have somewhat of a surplus of equipment, but I would point out that with low traffic volume you have not the same chance for utilization, and you have not quite the same surplus that might be indicated in the reverse direction.

Q. Now, having predicated your requirements on this average traffic volume, then you speak in terms of expanding national requirements as adding to that. Now, would you just say how you arrive at that?

A. The expanding national requirements merely means that as Canada grows, every 100,000 people added to the population requires a certain amount of traffic to support that population. We studied at some length both in Canada and the United States the growth in population as related to the growth in traffic, and we came up with the answer that on a normal increase -- no jags, but on an orderly basis -- 1,500 revenue ton miles per year per capita are created by growing population, and our increased national requirements are based upon examining each year what the growth has been and is indicated for the immediate year in front of you, in order to see what problems we have to face in the way of added transportation; so that we do not



propose that we assess this for five years in advance, but only from year to year, where we can read carefully what has happened and apply it to the immediate future; but for the purpose of indicating to this group we have taken the average increase in population in Canada per year for a five-year period as 250,000 people per year, so that this additional equipment for expanding national requirements is sufficient to take care of the traffic needs, that is, the Canadian Pacific to take care of its share of the traffic, of the traffic needs of an additional 250,000 people per year.

Q. Would you then turn to the table on page 36, and, without giving all the detail, point up anything you think would be required for an understanding of how that table is set up?

A. This first table, of course, as I said, only relates to equipment, and the first section is freight cars and passenger cars. This in turn is given in two references or two main divisions: first, the restoration of work capacity, which is divided into the value based on original cost, which is the amount that would be recovered through depreciation, and for which no carrying charges or amortization is charged, because that is already in our accounts.

Q. Or will be if your depreciation rates are sufficient?

A. Or will be if the depreciation rates are sufficient.

COMMISSIONER INNIS: Q. How is that divided between freight and passenger? Have you any indication of the relative importance?

A. Well, this, being merely for the purpose of giving you the total programme and the amounts involved, only has the groupings here. I have details and can dig it out for you if you wish, sir.



Q. I think it would be useful to have a comparison between those two items.

A. Well, I can tell you this, that it requires 2,100 freight units per year to restore our work capacity.

MR EVANS: 105,000 in five years.

COMMISSIONER INNIS: 105,000 freight cars?

MR EVANS: Yes.

THE WITNESS: That is merely to restore our work capacity. For passenger -- I can give you that: 495 passenger cars in five years.

THE CHAIRMAN: Q. 495?

A. I am sorry, I gave you the total for both restoration of work capacity and expanding national requirements. The restoration of work capacity which I am speaking to here, it is only 385 passenger cars.

Q. Passenger cars?

A. Yes.

COMMISSIONER INNIS: Q. That is, a year?

A. No; that is the total for five years.

THE CHAIRMAN: Q. 385 passenger cars for five years; and the other is 105---

A. I will give them to you total; it is 10,800 freight cars for the five-year period.

MR EVANS: I think, Mr. Newman, I put a fantastic figure on the record, making very bad arithmetic. You said 2,100 freight cars per year, and I think I said 105,000; I meant 10,500 roughly in five years.

THE CHAIRMAN: 10,800 new freight cars; is that right, Mr. Evans?

MR EVANS: That is as I understand it.

THE WITNESS: 10,800 new freight units to restore the work capacity that is lost in handling the business of that period.





MR EVANS: Q. That is for the next five years?

A. Yes.

Q. And 385---

A. Passenger cars.

Q. Passenger cars?

A. For the next five years.

COMMISSIONER INNIS: Q. What is roughly the cost of the freight cars and passenger cars?

A. Well, I gave you the average of our last programme as \$9,400 per freight car, but I would not take it at that, because that depends upon the proportion of different kinds of cars that are built into the programme.

Q. What about passenger cars?

A. And here I think the average that we have in here is \$7,500 per freight unit as the average; that is very close to it, Mr. Innis.

Q. What about passenger?

A. Passenger cars, the average I believe is \$75,000, if my memory is correct -- \$75,000 per passenger car.

THE CHAIRMAN: Q. \$75,000?

A. Each. Do you know what our new coaches are costing us, my lord? \$125,000 per car. Our new sleeping cars are costing us \$200,000 per car. It is fantastic -- and this is what we are trying to live up under.

MR EVANS: Have you been answered, sir?

COMMISSIONER INNIS: Yes.

MR EVANS: Q. Then you have a figure there of \$53,605,000, representing this original cost of an equivalent number of cars to be recovered through depreciation accruals, and then the excess cost is \$70,050,000?

A. That is right.

Q. And then your total gross expenditure on equipment is obtained by adding those two sums together and getting the



\$123-odd million that appears as the third figure in the column?

A. That is correct.

Q. Now would you pass on?

A. Well, perhaps I should point out that the excess cost of replacement over the original cost of the equipment must of course be charged interest and depreciation, which results---

Q. You extend that?

A. Which results in a debit to our cost, carrying cost to us.

Q. What you mean to say is that, having the separation between original cost of the new equipment and the increased cost or increase of replacement cost over original cost of that, \$70 million, you then have the division which enables you to assess the additional capital which you must---

A. Additional capital cost and the carrying charges on it.

Q. Now, in order to explain that perhaps a little before you pass on down that column, I notice the column headed "Interest at 4% Year 1955" contains a figure of \$2,802,000, which represents, as I understand it, interest on this \$70 million in the gross expenditure column which you have been discussing?

A. That is correct.

Q. And, similarly, the column headed "Amortization Year 1955" contains a figure of \$805,000, which represents these what you call amortization charges in lieu of depreciation. Now, in order that the Commission may understand what you are doing there would you explain why you use what you call amortization charges rather than to calculate depreciation?

A. This was really a general study for our own company,



and was an economic study to acquaint our management with what the order of expenditures would be and what the net effect would be upon the railway, so the programme was isolated as a complete unit as a study, and was made not in the accounting sense but in the economic sense, so that we considered that, instead of depreciation pure and simple, where the funds go into a depreciation fund and may be used as may be in the best interests of everyone, it is in the form of sinking fund, whereby it bears the same rate of interest as we charge ourselves on the capital expenditures, which gives if you like the net figure from an economic basis for the company.

Q. Now, out further on the same line we see a figure of \$3,607,000, which you put on the credit---

A. I do not see why it is credit. I have got it crossed out and made debit here, because really it is not a saving, it is a charge.

Q. It is headed "Net Savings", Mr. Newman; is that column wrong?

A. No, the net saving is right, but this is a debit to savings.

Q. A debit to savings; I see. Then that is the sum total of the two items appearing in the two preceding columns?

A. That is correct.

COMMISSIONER INNIS: The "Cr." should be "Dr.", then?

A. Yes, sir.

MR EVANS: It should be, yes.

Q. Then would you turn for a moment to expending national requirement? I see an item of \$72 million.

A. That is merely the total cost of the freight and passenger cars, the numbers of which are, for the benefit





of -- would you like the numbers, my lord, as to the expanding national requirement? In the five-year period for freight cars they are 8,500, and for passenger cars they are 110, and that is merely the total capital cost for that number of units to take care of the anticipated additional Canadian Pacific Railway traffic volume in the next five years.

Q. Which, as you say, is not superimposed on present traffic volume, but on the average which you look to?

A. That is correct; not on present, on average.

Q. Now, I do not want to take you through locomotives, but may I put it this way to you, that you followed a similar process with regard to your estimate of the locomotives required, and I see the same comparative items as we are given with regard to freight and passenger cars, but I see in the column which has hitherto been blank, the gross operating savings, the year 1955, a figure of \$8,575,000. Would you like to say a word about that?

A. Well, in brief, this is not on the same basis as freight cars or passenger cars, because when we buy diesel locomotives instead of steam, according to the requirements, which do vary somewhat -- and these are based upon averages -- two diesel locomotives will replace three steam, or three might replace four steam, so that the number of units is very much reduced over the number of steam locomotives that would be retired in that period.

COMMISSIONER INNIS: Q. How many locomotives would be involved in this?

A. In locomotives, to restore our work capacity in five years would be 245.

Q. And how much would they cost?

A. \$49.5 million.

Q. Each?



A. No, not quite.

Q. 245 divided into---

A. Yes. They vary. We pay \$135,000 for a freight diesel, and a freight locomotive may be anything from \$400,000 to \$800,000 each. I might say that there is a little distinction there. Perhaps you might want to ask me something more about dieselization later on, because these figures are really what we call diesel units, they are not of necessity locomotives.

Q. That is, 245 would be entirely diesel?

A. Diesel units, not necessarily locomotives. Two together might make a locomotive, and these are only units.

THE CHAIRMAN: Q. But you did mention diesel freight locomotive just now.

A. May I correct myself, then?

Q. And you gave us 6 the cost of it.

A. I gave you 245. Let me correct myself as saying 245 diesel units.

Q. Units?

A. Units, diesel units, which might be switching, might be passenger or might be freight, because they are all locomotives.

COMMISSIONER INNIS: Q. You want roughly the same for expanding national requirement?

A. 105 units in five years, which is roughly 50 locomotives.

MR EVANS: Q. As you use them?

A. As we use them.

Q. Perhaps you might just explain. I understand that these sometimes come in A and B units?

A. Well, I understood I was to say something about dieselization later on; if I could speak about the money now, Mr. Evans, perhaps we might not get into too many asides.



Q. All right. Then, having got your figure of savings, what have you to say as to the extent to which those savings represent a greater utilization of the new diesel locomotives than would be available in regard to the counterparts, steam?

A. Well, I am afraid that when I get into that, the work capacity of the diesel compared to steam -- I am afraid I will have to stop and give a few definitions as to the difference in the two beasts.

(Page 17677 follows)





Q. All I want to know in general terms is, is there a figure in that 8 million representing, or is there some provision in that figure representing, the resulting savings from this greater utilization?

A. A great deal of it is. Part of it is fuel, but most of it is utilization.

Q. Now, is there anything else you would like to say about that table?

A. Merely, I think, that in the same way as for the above equipment, that its gross operating savings, estimates are given, carrying charges and the amortization on the same basis, resulting in a net saving of \$6,700,000 per year. On the expanding national requirements we estimate the savings but we do not charge interest or amortization because we expect that the increased earning capacity of these locomotives will carry those to themselves.

Q. Anything else you would like to add on that table?

A. No, except that the last line is betterments to equipment.

Q. Yes.

A. A matter of \$4,400,000 over five years, which is merely a statement of the average amount of money that we are now spending on betterments to equipment. For example, just to give you one idea, there are improved brakes on freight cars which are a mandatory requirement in connection with the interchange of freight equipment, and things of that kind which we have had with us ever since the history of the railroad.

Apart from that one aside, we deduct salvage from the gross capital expenditures, which is really a credit to depreciation reserve, and then we arrive at our totals of



\$261,785,000 for the five years, what the gross operating savings would be in the next year after the fifth year of spending, and deducting the carrying charges from the gross savings and resulting in a net saving in the year 1955 (which would today be 1956 because we didn't do this in 1950 - we didn't have the money) of \$6,773,000.

That in general is speaking to the figures that are given in the table, which in turn are qualified by a number of footnotes which are self-explanatory, most of which I have referred to in commenting on the table.

Q. Is that all you want to say about that table?

A. That is all I have to say.

Q. Turning to the table on page 37, I see this table is entitled "Gross Capital Expenditures for the Road and Equipment Program for the First Five Year Period and the Gross and Net Savings as of the Year 1955". I see you have brought forward into this table the results of the previous table and as well have included the estimate for road property?

A. That is correct.

Q. Now, would you then tell the Commission what you think may be interesting to know about that table?

A. This table is simpler than the previous one in that it only deals with totals, and in the first part of it we give the road property extraordinary and the total of the equipment. Now, the road property extraordinary means the new things that we have to do over and above the things that we commonly do from year to year, or, in some cases, deficiencies of improvements to road property that we ~~were~~ unable to do during the past twenty years and which are now absolutely necessary. But they are over and above the year to year improvements that we are always doing, and it



constitutes, as we describe it, the extraordinary improvements to road property, and on which the gross capital expenditure is \$95 million, and in the same way as before the gross operating savings are indicated and the interest charges and the amortization which is handled on an economic basis the same as for equipment.

In the last part of the statement the ordinary expenditure for road property, the order of eight million a year, is given, which is about the order of what we usually spend on road property throughout what we might call normal times. The addition of the road property extraordinary and ordinary and equipment gives \$398,035,000, which is commonly referred to in round figures as \$400 million spending over the five years.

Q. Is there anything else you would like to say?

A. No, I don't think there is anything I can add to that.

Q. Perhaps I might direct your attention to this, that the ordinary expenditures on capital account for road property have opposite to them also the gross savings. Perhaps you would like to indicate why that is.

A. Well, generally speaking there is hardly anything we do on which capital expenditure is involved that cannot justify itself.

Q. By the savings you mean?

A. By the savings or improvements. We never replace a tool with the same kind of tool; it is always an improved tool, probably less in number than the original, but it is all capable of improving our position. All expenditures of that order are self-supporting in one degree or another.

Q. Now then, I think perhaps I should have asked you





this before. As head of the Department of Research, would you just give the Commission a short discription of the functions that that department performs. I am sure that this might take some time, but perhaps you could shorten it to a bird's-eye view of what you conceive the function to be?

A. Well, I can express it in a few words. I might say that the Department of Research was only started in the year 1945 due to what was considered the need of having one department to which the management could refer broad problems for concentrated study, or which could act in consulting capacity to other departments or which could conduct studi s which involve more than one department. In brief, the functions of the department are just about as broad as you could say, but in general they are directed to anything that would increase traffic, improve traffic, or would increase efficiency or develop economies. Beyond that there is no limitation.

COMMISSIONER INNIS: How large a staff have you?

A. It started with one man and after my struggles with organization during war time and all, I decided I would rather have a few men that knew something than a whole lot that knew little. So I have deliberately dammed back the growing staff, and right now we only have eighteen or twenty. We are slowly developing very competent men with broad knowledge, and of course we are going to grow, but I am going to keep that growth at as slow a rate as I can because I believe in quality rather than quantity.

Q. Why did you start so late? One thinks of various other organizations which - I won't say always have had such a department, but 1945 seems to be very late?



A. Well, of course one must look at it this way. In the first place each department in the railroad has its own experts, each must do its own research, each must know everything that is going on in its particular field; so that we cannot say we have not been doing research. We have.

Q. I understand that.

A. But if you like to think in terms of my previous reference to Volume I and Volume II, following the depression when not an extra dollar was spent that could be avoided, and following the war when we could not do anything because we had no men to do it with (our men were scattered all over the face of the country) we found ourselves under conditions that were so complex and so difficult that what was probably felt as a need became a very pressing need. That is why it was started so late, and I think part of it had to do with myself, because I was told they never thought they had the men they could spare to it, but as they found during the war they could get on better without me than with me, they thought my work could be changed and I could be given a new kind of work.

MR. EVANS: I am sure that the record will not really interpret the humour that I feel goes with that remark, Mr. Newman.

COMMISSIONER INNIS: Is that why they put you in charge of the Research Department?

MR. EVANS: Q. Mr. Jefferson just mentioned to the Commission the other day that when he is puzzled about what the Company can afford to do in making competitive rates, he has referred certain studies to you. Have you anything to say about that?

A. Nothing except that we have gradually put ourselves in the position where we have been able to develop such



broad and specific knowledge that we are able to really act in a consulting capacity to other departments, and they can readily refer to us problems on which changing conditions and all have perhaps made them less sure of their position, and they ask us to look into the problem and advise them as to whether we consider any proposal as being satisfactory or inadequate. Consequently, we are receiving from Mr. Jefferson quite numerous requests for investigations into various rates, principally competitive rates, others non-competitive, others purely rail rates, and we welcome them. If anything it increases our knowledge of the Company's operations, puts us in a better position to serve the Company.

COMMISSIONER INNIS: Has the Development Department - is that the title, Mr. Evans?

MR. EVANS: We were talking the other day about the Industrial Development Department which had the function of developing industrial traffic.

COMMISSIONER INNIS: Q. Do you work with that department?

A. No, that does not come under me, although I do have several occasions to discuss problems with that branch of the Traffic Department because that comes under Mr. Jefferson.

Q. You said something earlier about your interest in the development of traffic.

A. I meant from the standpoint of the development of traffic for the Canadian Pacific Railway in gross, not only specific.

Q. Oh, I see.

A. For example, if we can indicate more economic means of handling our traffic which would enable us to compete





better, why then, we would develop traffic.

MR. EVANS: Just so that we will have no confusion with the Department of Industrial Development of which you have been speaking which reports to Mr. Jefferson, I understand your superior officer is Mr. Crump?

A. That is correct - not in the research.

Q. Not in the research?

A. I report to the President direct.

Q. I am sorry, that is my mistake, but motive power and rolling stock - -

A. As chief of motive power and rolling stock I report to Mr. Crump, but needless to say our organization is such that I confer on research matters just as much with Mr. Crump as I do with the President, even more so.

Q. Now, Mr. Crump in his evidence said something about the diesel program. Would you like to indicate the general plans which the Company has in mind in connection with that program, and also how they go about getting a plan for the operation of diesel engines in lieu of steam locomotives?

A. I am hesitating as to how little or how much to say.

Q. I just want to get a general bird's-eye view of what you do.

A. I don't know in the first place whether the Commission have a good idea of why the diesel is replacing the steam, what it can do. In a few words I can tell you that it is due to, first, that the thermal efficiency of diesel locomotives on the average at the rail is 25%, and it is 5 for steam; so that in terms of work done actually we would expect our fuel consumption with the diesel to be 1/5 of what it is with steam.



THE CHAIRMAN: ' You mean in cost?

A. Well, not in an amount but actually the average saving in fuel in terminal service is 80%, in freight service 65%, and in passenger service 50%. Now, those are only generalities depending upon the relative prices of diesel oil and coal and upon the conditions of use, so that it is not only the thermal efficiency: it is the way you are able to use the tool that produces these savings. The characteristic of the diesel locomotive is entirely different from the steam locomotive. The steam locomotive is really just a steam engine turned upside down with a multiple number of flywheels with flanges on them running on the rail; and you cannot get power out of a steam engine unless you get piston speed which means miles per hour. So that you cannot develop the maximum horse-power of a steam engine until it runs faster, 35 or 45 miles per hour, depending roughly on whether it is a freight or passenger engine. I would say 45 is probably the figure to use because nearly all of our freight locomotives today are really passenger locomotives with large wheels.

Now, when you come to slow speeds you may have great thrust from your steam on your pistons, but you have got a low horse-power. Now, with the diesel it is really an electric locomotive; that is a proper way to describe it. All the diesel engine does is to drive the generator that develops the electrical energy which feeds the traction motors. By varying the way you feed the field current through the traction motors, it is equivalent to the transmission of an automobile, and the combinations are such that you can get the maximum horsepower developed at the rail with a diesel locomotive at speeds right down to and below six miles an hour. So the ability to work on the part of



the diesel locomotive over a wide range of speeds gives it a natural advantage over steam.

Now, the way that works on the railway (and this is one of the most interesting things about the diesel locomotives) is that you set the tonnage for what we call a balancing speed; which means that we have enough tonnage on the diesel locomotive so that on a straight and level track, we will say, it balances its speed at 45 miles an hour; as long as that track is straight and level it will run at 45 miles an hour. Now, if it comes to curves, if it comes to grades, all that happens is that the added resistance will slow the locomotive up, but as soon as it slows it up the tractive effort rises, that is, the pull that the diesel locomotive exerts, and that tractive effort can go way beyond what the steam locomotive can do. The steam locomotive has a maximum tractive effort of 58,000 lbs. The equivalent horse-power in the diesel would have a maximum tractive effort of nearly three times at low speeds. So when you come to severe grades all that happens is that the diesel gets slower and slower and generally speaking it will crawl over the grade at 10 or 11 miles an hour. If the grade is short and quite severe, it may get down to 3 miles an hour, but it will crawl over it as long as the tonnage is correctly apportioned.

Now, that means that the diesel is self-governed. Open the throttle, and the engineer has nothing more to do except to control it if it goes too fast down grades. Everything becomes merely automatic. Then in the final analysis over a division in a definite part of the line, we examine the locomotive or grades, all those conditions, and see what the total elapsed time is from terminal to terminal.





If it gives us the desired result that is the tonnage rate. If there are too many grades and it slows it down, why then, we have got to lessen the tonnage which raises the speed on the level part.

Now, by doing that, it means that in most of our studies we find that the tonnage that a diesel locomotive can haul is <sup>very</sup> greatly in excess of what a steam locomotive can haul. Consequently the number of trains is reduced or, conversely, the capacity of that section of the line is increased; and in both directions we have improved the capacity of the railway, and also we have reduced its expenses by reducing the number of train miles.

Now, that in general is what the diesel is, and what it does. Now, how do we go at it? The diesel locomotive with its high cost must be utilized to its maximum extent, and it is something like an airplane. An airplane is no good unless it flies; it has got to have a high flying mileage or else you cannot get any return from it. The diesel locomotive standing still just eats its head off, but the diesel locomotive running will make money for us. So we must plan to use the diesel locomotives so that they are used as nearly continuously as possible.

The first thing to meet that requirement is a complete change in maintenance. We don't repair diesel locomotives. What we do is, we repair the components and parts of the diesel locomotive, and by adopting a series of checks and inspections, <sup>as</sup> they do for aircraft, if any part or component is not functioning satisfactorily it is removed and one that works properly is put in its place. The defective - or even if it may not be defective, the part that is out of adjustment, that is fixed off the locomotive.



Consequently you don't hold your locomotive for repair; you hold it the minimum of time in order to replace parts or replace components. In doing that you are developing the utilization of diesel locomotives up to as high as 85% of the calendar time, and some roads have achieved over 90%.

Q. How would that compare with the steam locomotive?

A. Well, it is probably double or better. Now, when we start to think of where and how we are going to use them, we naturally think of getting the best results out of them. So in our planning for the use of diesels we go to areas which we can completely dieselize, where we can change the maintenance facilities, change the fueling facilities, eliminate to the greatest possible extent all steam locomotives, and with a staff trained to handle diesel locomotives only.

In our general plans we have moved to areas where on account of special conditions it is desirable to replace the steam locomotives, such as out in Vancouver Island with the Esquimalt & Nanaimo Railway, and sometime there is the Dominion Atlantic or Quebec Central Railway; and for the main lines of the railway in such large areas as Montreal to Wells River which was converted to diesels last year as 100%; and the Schrieber division which is 517 miles along the North shore of Lake Superior, which is being dieselized this year. Then we have under preliminary or detailed study numerous other areas, and it takes us a whole year to study an area, to see what is necessary to do and to assess every feature of the operation of that area to see what the economic results may be that can be secured with the introduction of diesels.



Now, due to the change of maintenance policies we figure that in general there should only be six primary maintenance points across our main line, and that all diesels will be based upon the six primary points, and other points will merely be turn-around points or what you might call minimum maintenance points for the maintenance of diesel switchers which would only be one or two in number.

The study, to be complete, is most complicated and most exacting, and it requires looking into every single operation in any particular area; but it is most important in thinking of dieselization as applied to a railway to think of the opportunity which there is to achieve high utilization of the low traffic volumes. Consequently in our thesis of how to dieselize the main line of the C.P.R., we will have an area here, and an area here, and perhaps one or two here, so located with balancing regions or areas between, that when traffic declines below the peak in <sup>the</sup> one of the completely dieselized areas, their operations can be extended into the adjacent balancing area and steam locomotives tied up so that we will continuously get the benefit of all our diesels throughout the whole area or throughout all volumes of traffic, areas of varying volumes of traffic.

THE CHAIRMAN: Just as a matter of interest, you did say a while ago that a diesel engine which is not working simply "eats its head off". How does that happen?

A. Well, it saves fuel and it saves train miles when it is working.

Q. You mean some other engine must do the work for it

A. No, if you don't use it is not saving money.





MR. EVANS: Q. It is costing you money for interest and so on?

A. Your charges for the diesel go on all the time, maintenance and depreciation and your interest charges on it, and they are very high because diesel locomotives are expensive, and you cannot meet those charges unless it is out working, and when it is working, working continuously.

Q. I wonder if you meant depreciation, because on the user basis we do not accrue depreciation when they are not operating.

A. Well, as a matter of fact it only would do when we are not operating; it is in terms of miles per year and that is only relative.

Q. Perhaps in view of the very attractive matter of diesels, somebody will be wondering, Mr. Newman, why you could not just change overnight and put all the steam locomotives out and make a lot of savings by complete dieselization of the entire railway.

A. That is not possible, and it is not possible for the reason that you cannot get your desired type of maintenance of diesels generally by mixing steam and diesels. It requires different types of men; we need more electricians and fewer mechanics.

Q. What about training your staff?

A. Well, I was going to add that, Mr. Evans. Our greatest problem right today is to develop the kind of men we need to maintain diesels, and when we start to dieselize an area, for nearly a year in advance there is a constant stream of supervisory officers and mechanics and electricians going to diesel schools, being educated in



what the diesel is and how to maintain it, and that is all preliminary. We will<sup>not</sup>/let diesels go to an area until the maintenance staffs and the supervisory staffs have been educated in how to care for and maintain a diesel.

Another thing, when you introduce diesels, all of the men who have never had them before, require quite a little period before they produce the best results; and we ourselves, supervisory officers who are planning the method of operating diesels, we cannot be confident of our accomplishments until we have had them and tested them. So we find that the dieselization of one area is as much as we can digest in one year. Roughly then we figure that a maximum of 68 or 70 diesel units is as many as we can digest. Consequently it means going slowly unless we are to waste a lot of time and effort and money in trying to get results out of them from people that are not really used to them..

THE CHAIRMAN: This may be a good time to adjourn.

...SHORT RECESS

(Page 17693 follows)



---On resuming:

MR. EVANS: Q. Now Mr. Newman, Dr. Angus asked you a question which I do not want to leave unanswered, if there is some further information he feels he would like to have. The question related to the savings from \$195 million. You will find that at page 11 a statement is made, which you read from the brief, that the entire programme is by no means all likely to produce operating savings. You spoke of the purchase of the equipment consisting of freight cars and passenger cars to restore worn-out work capacity and to meet expanding rail requirements, and the figure of \$195 million was used in that connection.

Is there anything you would like to add to what you said in answer to Dr. Angus on that question?

A. I think probably your question would then be focused clearly on only freight and passenger equipment that is required to maintain the level of our work capacity, as to whether any economies would be derived from having those cars put into our inventory.

Well, we don't feel that there would be any definite savings, the reason being that we do not put back into service freight unit for freight unit; there are probably far less numbers of units go back into service than go out of service in any one year. Consequently, we feel that the maintenance on the work capacity basis will remain at or about a level. In passenger equipment, I am sorry to say, every new passenger car we add to our inventory our maintenance cost goes up. The reason is that air conditioning, and automatic heating requirements and all the doo-dads that are required for modern transport substantially add to our





maintenance costs for every new passenger unit we put in the service.

Another point that I might mention in freight equipment is that one type of car that we are building a lot on now is refrigerator cars. We are adding greatly to our stock of refrigerator cars. The modern refrigerator car has a very high maintenance cost. It is efficient, but we have to pay for the efficiency with high maintenance. And balancing all those various factors, we could not see any justification in assigning any freight savings to the portion of the freight and passenger equipment that would be required to maintain the level of our work capacity.

COMMISSIONER ANGUS: When I asked my question I had not really appreciated that all these financial calculations were on the basis of requirements; I was trying to see if they involved a sort of protection of the rate base and net income for five years, and of course they do not.

MR. EVANS: They are not related . . .

THE WITNESS: They don't, sir, they spring from engineering requirements rather than having any relation at all to the company's financial position. These are all of engineering origin.

MR. EVANS: Q. There was another question I asked you and you requested me to postpone the question. That is, we were talking about so many units of diesel motive power that were involved in the programme, and I asked you to distinguish between (a) and (b) units. Now, just shortly, is my understanding right, that the (a) unit is the unit in which the engineer and fireman sit, and which is the indispensable unit, as it were,



and can operate separately to pull a train.

A. That is correct. A (b) unit in itself cannot be operated on the railway. It is merely what you might call another power carriage, or another power unit; it only goes when it is attached to an (a) unit which has a control cabin in it.

Q. So that when you require a certain amount of power which an (a) unit alone will not produce, you add one or more (b) units to the (a)?

A. That is correct.

Q. Before I leave the question of motive power -- and if you will be fairly short on this -- would you tell the Commission something about the research that is now being done into new forms of motive power, and particularly would you discuss for a moment the gas turbine as a future means of providing motive power?

A. The gas turbine is a very promising type of new locomotive, but it is no different from the diesel, except to take the diesel engine out and drive a generator by a turbine which, in this case, is a gas turbine which is merely an air compressor with fuel burned in the compressed air; and that compressed air is burned in a turbine to produce useful work, which in this case is driving the generator.

Now, there are just two things about the gas turbine that make it so attractive to us. The first is that it will burn low grades of fuel. Today it is practically an accomplished type of prime mover for the burning of Bunker "C" oil. Bunker "C" oil in western Canada today, such as we are burning in our steam locomotives, is about a third to a quarter the cost



of diesel oil.

There was also the possibility of burning coal in gas turbines. You will be interested to know that here in Canada there are various research groups with which I am working that are working on certain phases of developing a gas turbine that can burn Canadian coal as well as Bunker "C" oil. The other point that makes it attractive is that the gas turbine is merely an air compressor, and the colder the air the more nature compresses it for us; so that the colder the temperature in the winter, the less work you have to <sup>do</sup> to compress the air, and the more work is available to drive the locomotive. Actually between 60 degrees Fahrenheit and zero the gas turbine can double its power. Now we wouldn't use all that in a locomotive, but our preliminary specifications do call for the electrical capacity to be such that we can use 25 per cent of that increased power as the temperature falls. So as the going gets tougher the locomotive gets more suitable to do the rough work.

Those two characteristics, the ability to burn cheap fuel and the increased power in the winter time are the desirable characteristics of the gas turbine locomotive, that some day, perhaps within five years, we will start to be able to use the gas turbine adapted to only some of our transport operations. They will only supplement the diesel; they will not displace it entirely.

Q. Now, I turn to another subject. At page 9639 of the transcript the Canadian Automotive Transport Association had a recommendation that the Railway Act of Canada be amended so as to prevent an acquisition of highway transport operations by the railways, and by





that I understand they meant over the road highway transport operations. Would you tell the Commission, from the standpoint of the research department, your views as to any such restriction on the powers of the railway companies?

A. Well, in our review of the future of the railways, we consider that we are a transportation company, and that we must have the ability to use any form of transport that will enable us to fulfil our obligations to the nation of providing good transportation at the lowest possible cost.

To illustrate what I mean I might say that the Canadian Pacific is more than 50 per cent branch lines, and a great many of our branch lines do not pay their way. The development of highways in Canada, as compared to the United States, is still in its early development stage. It is inevitable, as highways grow in mileage and in capacity, that our branch lines will be affected. We believe that the time will come in Canada, as it has in the United States, that it will be desirable in the best interests of Canadian transportation for us to replace some of our branch line operations with highway operations; and we feel that it is essential for us that it be recognized that, as a transportation company with an obligation to the municipalities and to the towns in different areas to provide transportation, that we should maintain the right to do so.

Q. Now suggestions have been made that if the railways desire to provide such services, either by motor truck or motor bus in conjunction with their railway service, that they should be limited to making arrangements with the existing motor carriers under contract.



What are your views about that?

A. We follow that practice where it is considered desirable to do so; but in the future, in places in which we would be interested in the replacement of rail with highway traffic, such as I have mentioned, I think it is absolutely necessary for us to have the right to go on the highway ourselves. As I said, we would only do so in most cases where our losses are severe. We are not allowed to discontinue services<sup>as</sup>/we wish; we have to secure permission. All that we would do in most cases is to reduce a severe loss to a lesser loss; and I am doubtful in all cases whether or not the kind of business we might have to do would be attractive to anyone on a contract basis. It would be vital to us, because in that way we could substantially reduce our own losses.

Furthermore, it is rather necessary for us to always keep sight of the fact that goods flow from the railway to the highway in such places, and from the highway to the railway, and our being engaged in highway traffic would put us in a position to protect that. We believe that in many cases the highway trucker would be more interested in developing his own traffic than in protecting railway traffic.

As our traffic volume is necessary for over-all<sup>an</sup> transport picture, we believe it is in the interests of the nation for us to be able to do these things as conditions require; and each specific condition will, of course, vary to some degree.

Q. Other suggestions have been made that the<sup>to</sup> limitation/be put upon the right of the railway companies to own highway transport might perhaps be compromised in



the same way as it was done in the United States, that is to say, to permit the railways to own the highway services based on the so-called Key Point System.

Now, for the information of the Commission, the Key Point System is that railway companies may operate motor trucks only where the freight being transported has had, or will have, a rail haul. That is to say, you bring the incoming traffic to a so-called key point, out of which radiate the operations which are done on the highway.

Now then, Mr. Newman, would you give me your view as to any limitation of that kind which you think --

THE CHAIRMAN: Before Mr. Newman answers the question, did you say that there was such a limitation in the United States?

MR. EVANS: Yes, there is. I am not sure I can refer the Commission to it, but there is a limitation put upon the right of a railway company to operate motor trucks on the highway; and that limitation is based on the so-called Key Point System. I think it has been referred to in a number of cases being as/perhaps a desirable compromise between complete prohibition and complete freedom.

THE CHAIRMAN: And this applies to railways which are under the jurisdiction of the Interstate Commerce Commission?

MR. EVANS: It does, sir; but whether it is in the Interstate Commerce Act, I do not know. I am informed that the question of that limitation is on its way to the Supreme Court now, so that perhaps it is not too clear just what the limit is.

THE CHAIRMAN: Do you know whether this limit exists in the case of state railways?





MR. EVANS: I couldn't tell you that, sir, but the suggestion is put forward here that there should be that limit at least.

THE CHAIRMAN: Yes, I know. I thought I might get more knowledge about the situation in the United States because there I understand they have State Railway Control Boards which regulate state railways.

MR. EVANS: Yes.

THE CHAIRMAN: Intra-state transport.

MR. EVANS: Intra-state traffic.

THE CHAIRMAN: You cannot tell me whether or not they limit the use of the highways to its railways?

MR. EVANS: I do not know. Mr. Hume is here; perhaps he could answer that question.

THE CHAIRMAN: Mr. Hume?

MR. HUME: Mr. Chairman, I do not know the answer to the question that you just asked but I shall attempt to find out what it is. I am not familiar at all with American regulations on this particular point, except as to the 1946 report of the Interstate Commerce Commission, which, I think, is on the transcript at about page 54 -- or an excerpt from it -- in which the Interstate Commerce Commission states in their annual report of 1946, that they were conditioning all grants of licences to the railways for the acquisition of highway transport under section 207 of their Act to cases where such highway transport was ancillary to or supplementary to rail transport.

THE CHAIRMAN: But I am interested presently in the case of the Board regulating state railways,



within a state. There are such things in the United States.

MR. HUME: I do not know as to that, Mr. Chairman.

THE CHAIRMAN: With the state having, I presume, the ownership and control of the highways, it would be interesting to know what it did in that sort of case.

MR. HUME: I was not aware, Mr. Chairman, that there was any state railway. I do know, of course, that there are --

THE CHAIRMAN: There are; there are also state regulation boards who run them.

COMMISSIONER INNIS: I think Alberta had some conditions in the case of the Canadian Pacific . . .

MR. HUME: Yes, Dr. Innis. Alberta's evidence, given by Mr. Harries, was that in that province they were refusing to extend licences, but I don't think they went beyond that point with the railway companies, other than for the number of vehicles they had at the moment.

(Page 17703 follows)



THE CHAIRMAN: Well, if anybody can find anything to throw light on the question---

MR EVANS: There is this to be said, sir, that the existence of state commissions does not in itself indicate that there are any large number of state railways.

THE CHAIRMAN: No, no. but, there being commissions, they must regulate some---

MR EVANS: Intra-state traffic. They regulate it from the standpoint of the traffic.

THE CHAIRMAN: I understand they must regulate railways, because, reading some of these cases which you mentioned to me, I find that certain railways are regulated by an intra-state railway commission.

MR EVANS: Yes; the railway itself might be an interstate railway, but it is regulated by the state in respect of intra-state business.

THE CHAIRMAN: That may be, but <sup>if</sup> in any such state which has such a commission any provision is made about the use of highways, it might be interesting for us to know.

MR EVANS: I would think they would be very, very minor.

Q. Now, having put that question to you about the keypoint system as a limitation, have you any views to express as to whether the railway should be limited to that?

A. Well, the views of the Research Department in regard to future traffic of the company is that in the event of our supplying in a depressed area highway transport instead of rail transport, we must not be denied the right to give transport facilities to points that lie entirely on the line which no longer operates. We have obligations for service in these areas, and to say that points that lie twenty-five and thirty-five miles away from the connection point with the main line could not be served by our trucks





would be to deny them transportation facilities that they now have on the railway, consequently we feel that if we require in the future, as we expect, to reduce losses on non-paying branch lines, by replacing them with highway services, we must have the right to give service between points on that branch line as well as only to goods that might move off the main line or on to the main line.

Q. Would you illustrate that, Mr. Newman? I was going to ask you to use Brandon as a point where, for example, the keypoint system might restrict you to operating in and out of Brandon with traffic that was to have or had had a rail haul to or from Brandon from points beyond. Now, would you illustrate just what you mean when you gave your previous answer would happen to say traffic originating in Brandon which did not have a rail haul, but going to the same points as are served by your trucking operation?

COMMISSIONER INNIS: When you said "beyond" you meant in Manitoba or in Saskatchewan?

MR EVANS: Any place in Canada, as long as it has a rail haul, the trucks operating from a key point can carry the traffic. But the point I am asking the witness to clear up is, what would happen to traffic originating at the key point which had not had a rail haul but would be going to these points already served by truck?

THE WITNESS: It merely means, for example, that if business originating in Winnipeg was sent through Brandon to points surrounding Brandon and delivered from Brandon by truck, the people in Brandon would be denied that competitive service to the points surrounding them, and would be at a disadvantage in connection with points that they would naturally consider their area. Consequently in this particular case we were requested by such areas to give them the same truck service that we were giving to the



distant points, so that there a situation arises which may discriminate against surrounding points to a town such as Brandon.

COMMISSIONER ANGUS: Does this question raise an issue of provincial jurisdiction? If a branch line is replaced by a truck service, is a provincial license required?

MR EVANS: I would say so, if it is a purely provincial movement. If it is an interprovincial movement we would say no, that that is within the exclusive jurisdiction of the Dominion. Our position---

THE CHAIRMAN: Do you mean to say including the use of the highways?

MR EVANS: Well, sir, the right to use the highways and to be taxed for the use of the highways I would think undoubtedly remains with the province under any system of Dominion regulation, but the issuing of licenses for interprovincial movements we think is clearly within the jurisdiction of the Dominion.

COMMISSIONER ANGUS: Does that mean that when you apply to the Board for the right to abandon a service you are not in a position to know whether you can get a license or not to replace the rail service by truck?

MR EVANS: It might be.

COMMISSIONER ANGUS: That would be very awkward, wouldn't it?

MR EVANS: Yes, it would be very awkward, if there were a prohibition either in an individual province or a prohibition in the Railway Act which might go to the power of the company to operate.

COMMISSIONER INNIS: Would it be easier for you to arrange for the use of buses and so on if you were trying to replace a branch line crossing a provincial



border than it would be within the border, in your view?

MR EVANS: You mean under present conditions?

COMMISSIONER INNIS: I was thinking of the position you seem to be taking as to---

MR EVANS: If there were regulation by the Dominion interprovincially and regulation by the province intra-provincially?

COMMISSIONER INNIS: Yes.

MR EVANS: I would not think so. I do not see any reason why, except that some provinces have taken a rather violent stand on the subject, but I do not know that they all have.

COMMISSIONER INNIS: Your view would be that you would have a clear right in the case of interprovincial branch lines to replace by truck, whereas intra-provincially you would not?

MR EVANS: We would have a clear right, sir. I would not suggest that the regulating body should, just by præcipe, as it were, give us a license. I think everyone agrees that it is in the interests of regulation that there should be a certificate of public convenience and necessity required, and I think we would in the case you mention probably be able to establish that the abandonment of service on the rail justified the substitution of the highway service, but that would be a matter for argument in a particular case. That should be the same when you are applying for an intra-provincial license or an inter-provincial license, because the same reasons exist, and most of the provinces do require some evidence of public convenience and necessity.

COMMISSIONER INNIS: I understood that you thought you would find it easier to maintain your position as to federal jurisdiction on the interprovincial than on







the intra-provincial.

MR EVANS: I don't know that I had any view that it would be easier, but I do think that as a matter of a proper system of regulation uniformity is extremely important, and I do think that, since the Dominion has power within a certain field, perhaps the easiest initial step toward uniformity is to have the Dominion exercise that jurisdiction, in the hope that the provincial governments would come into line and agree on the uniform regulations they would adopt. There is a suggestion in the Railway Association brief on that subject to which our company subscribed, but I haven't it at my fingertips at the moment.

COMMISSIONER INNIS: There was some indication, I think, in Mr. Sinclair's statement that the interprovincial trucking rates were now quite out of line with the intra-provincial rates.

MR EVANS: Well, that may be a matter of fact.

THE CHAIRMAN: Then who is to question Mr. Newman?

MR COVERT: I had just a very few questions, and I thought I might finish---

THE CHAIRMAN: None of the provincial counsel?

MR COVERT: I think they have some, sir, but I thought I might finish before one o'clock. I spoke to Mr. MacPherson and Mr. Frawley about it.

EXAMINED BY MR. COVERT:

Q. Mr. Newman, I wanted first to get a little more information about your Research Department. You intimated that you had now about eighteen in the Department, and I wanted to know if you could tell me just what kind of personnel they are; for instance, have you engineers, accountants, economists, and so on? Could you give us a breakdown



of that?

A. Yes, only let me say first that the Research Department does not attempt to replace the experts in our departments. We co-ordinate the thinking of all departments concerned, consequently our men, while they initiate, conduct the studies, they are done very closely in conjunction with every department that is concerned, and when we make a report it is a joint report subscribed to by every department concerned with the recommendation, so that we have the use of the specialized experts in all the departments. As I say, I have electrical engineers, mechanical engineers, civil engineers and economists, and those with accounting training, which covers the field of necessity as far as we have gone. We have no minister of the gospel.

Q. Now, just pursuing that a little further, for instance if the matter of a study that involved rates came to you, you would of course use the men in Mr. Jefferson's department?

A. Not only in Mr. Jefferson's department, but in the accounting and the statistical departments. All knowledge on costs must spring from records plus field examination of the particular circumstances that surround any particular case.

Q. Now, I gathered from what you said, Mr. Newman, that this programme that is referred to in your brief had been delayed because of lack of funds; is that correct?

A. That is correct.

Q. And is it being further delayed because of that?

A. Yes.

Q. And is that due to inability to raise capital? Is that your main---

A. Yes; we cannot finance programmes of this magni-



tude without raising new capital.

THE CHAIRMAN: Does this inability that you discovered, Mr. Covert, mean any failure of attempts to raise capital?

MR COVERT: Any failure of attempts to raise capital -- that was your question, my lord?

THE CHAIRMAN: Yes.

MR COVERT: Q. Have you made---

A. We are denied the right to raise the type of capital that we consider is a most essential part of all added facilities to the company, which is ordinary share capital, and we cannot even ask for it until it comes to par; we are prohibited.

Q. Does that mean, then, Mr. Newman, that this programme cannot proceed at all until the common stock reaches par?

A. I think it does in general. I might say that the period of large spending that I referred to, ten years following the First World War, was the last time that we had large share issues, additional share issues of stock, and it was very largely financed by additional share capital. All that we can do here under our present circumstances is spend what money we have available and can raise by ordinary means, and present indications are that the five-year programme will be delayed considerably.

Q. As a matter of interest, Mr. Newman, this programme set out in the brief, is that something that originated with you?

A. It started with me when I started in the year 1945 to study the position that the company found itself in and what was necessary for us to recapture our position of -- what I mean by recapture our position is, our low-cost position, because all down through the years we have always





succeeded, in spite of rising costs, in keeping our costs down to the point where the price paid by the shipper was, we felt, the lowest, and is the lowest, anywhere you could find; and the facilities that we had certainly would not and will not today do that, so we started out to make, I might say, a long-range review of the position that the company found itself in, and had done a good deal of work when it became apparent that it would be very valuable to point it up to the immediate problems we had in the year rather than attacking them if you like separately on the fingers of the hand as one thing; so we then initiated the study through departments and through our own group as to what the immediate requirements are.

Q. Then, Mr. Newman, having developed this programme, it has generally received the commendation of the other departments in the railway?

A. Yes.

Q. And also of the board of the company itself?

A. It has become the company's index as to our requirements, and is subscribed to and was participated in by all the departments, sir.

Q. Now, does this dieselization programme present any difficulty with labour?

A. No.

Q. Has this been discussed with them too? Is that part of the---

A. The dieselization as it stands comes under our existing agreements with labour; no difficulty so far.

Q. I understand the Canadian National has a dieselization programme; you would be aware of that?

A. I am not familiar with it. I know that they are just as interested in it as we are, but just what their programme is I do not know.



Q. Do you discuss with them problems of this kind to get---

A. I have had several discussions with them, their research, their mechanical department.

Q. What I wanted to find out, Mr. Newman, was whether the two major railroads in Canada did co-operate on what you might perhaps call long-term planning of this kind, and get each other's ideas, or are they---

A. Well, I could say that as far as I am aware and as far as my discussions have gone, we are quite in accord with the use of the dieselization. The same statement has been made by the Canadian National, that they do not intend to buy any more steam locomotives, and just how they will use the diesels I am not in a position to say, but in general I would think they would do it very similarly to what we are doing. I do not know of any programmes that they have made quite the same as ours, but it is a natural way to do it, and I assume that it would be done in very much the same way.

Q. Now, if you go into the dieselization programme, is there a serious problem as to what you will do with your present steam locomotives?

A. No. We always need locomotives, and there is a tremendous area, or let us say a very large mileage, in which we will always be using steam locomotives, because we could not get the utilization for diesels, and we have even studied that to see just how much mileage we would have to run before we could even consider diesels, and in general there will be a considerable number of steam locomotives used for a great many years to come, certainly fifteen years, as far as we can see. Now, all that will happen is that there will be a bettering of our position, because the best of our steam locomotives will go into other ser-



vices, and gradually the least efficient and the oldest of our locomotives will be retired.

THE CHAIRMAN: Q. Does that mean that you may keep on buying steam engines?

A. We won't keep on buying steam, because the type of service that we have for them comes under the very broad term of marginal use in a great deal of the areas where they won't be used very intensively; consequently they are quite good enough for the next ten to fifteen years.

MR COVERT: Q. You do not anticipate, then, Mr. Newman, that it will involve the sale of any existing steam locomotives?

A. No. You couldn't sell them anyway, Mr. Covert. Steam locomotives are not saleable; they are a dime a dozen in the States, as the saying is.

Q. Now, Mr. Newman, in connection with your Research Department, has that Department made a study of the economic range of trucks?

A. No. We as a department, the consulting department, and generally, are only concerned, and all that I am concerned with is, the broad -- the future requirements for transportation as we see it in order to serve the country the way that we consider we must.

Q. Now, Mr. Jefferson indicated to us that his department would refer to you certain of his problems; for example, I think one of them was that he would ask you to make a study as to whether or not they could afford to put in a certain rate. Now, I do not want to get this wrong -- perhaps Mr. Evans will watch me very closely -- you might have a new industry being built, a proposal, a group of people proposing to build a new industry, and they want to know what the rates will be, what rates they can get; I understood from Mr. Jefferson that he would sometimes refer these matters to





your Research Department for study?

A. That is correct.

MR COVERT: That is right, isn't it?

MR EVANS: Yes, with some modifications, but substantially correct. I think what he meant was that if the negotiations proceeded to a point where the industry said, "We have to have a certain low rate," he might have to abandon his usual tests and let Mr. Newman make a study.

MR COVERT: Q. Mr. Newman, I just wondered what your department did in a case of that kind, what study you would make, how you would arrive at conclusions?

A. Well, there are certain things that from our general knowledge we do know. We have made several very large studies of cost of moving traffic in volume over certain areas, and the more of them you make the more familiar you become with your whole system and what you can do in different areas; but if there is any one commodity that he wishes to have studied in particular, we look at it from the standpoint of the volume, whether it is a guaranteed volume, whether it flows day after day or only once a week or once a month, the kind of equipment it uses, whether there is use for that equipment in a return movement or whether it has to be a special empty movement with special cars, and the nature of the commodity, its density, its cost, and all of the various factors that a railroad has to face, because we are an insurance company against loss and damage as well as everything else. Then we actually look at the particular line over which it is going to move, and go behind the general accounts that we have by reference to our accounting department, and attempt to build up and do build up what are generally considered average costs over that particular line, under the temperature, the weather conditions and all that we have, and we



build up a picture of actual cost, which<sup>is</sup> not accurate -- because no cost is ever accurate on a railroad; it can only be approximate, because there are so many variants -- but sufficient to more or less base your rate on, and then the fixing of the rate is by Mr. Jefferson. We can merely give him the base on which it must be fixed.

Q. So what you would eventually arrive at, Mr. Newman, would be in effect to present an additional and perhaps a little better test than Mr. Jefferson's department would have from the rule of thumb test such as car mile revenue and so on?

A. Mr. Jefferson with his vast experience can almost look at anything and in general say whether it is going to be worth our while or not, but Mr. Jefferson is handicapped by the fact that when your operating ratio approaches 100, his ability to more or less apply approximations is restricted. We have got to be far more exact; we cannot take things that may be a little bit below an average cost, because we consider it is to our benefit to do so; we have got to watch them very, very closely.

MR COVERT: In this connection, Mr. Chairman, I wondered if we might ask Mr. Newman if a copy of a study could be made for the confidential use of the Commission, and whether he thought it would be of value---

THE CHAIRMAN: A copy of what?

MR COVERT: Of one of such studies, to be made for the confidential use of the Commission, and whether he thought it would be of much use to us.

THE WITNESS: Well, I don't know whether it would be of much use to you or not, Mr. Covert. All these things require careful interpretation, because the conditions are---

MR COVERT: Well, we might ask for that.

THE WITNESS: Well, I would leave that to Mr. Evans



to say as to whether he would wish to do it, because that is a matter of policy, and not for me to decide.

MR EVANS: As far as I am concerned, anything for the confidential use of the Commission, Mr. Newman, would be approved by me.

MR COVERT: That is all.

MR HUME: Mr. Chairman, with your permission, just perhaps one question, one or two questions, of Mr. Newman. I understand Mr. Newman---

THE CHAIRMAN: When you say one or two questions, do you really mean one or two subjects to discuss?

MR HUME: One or two questions, Mr. Chairman.

THE CHAIRMAN: All right -- because our time is short.

MR HUME: I realize that, Mr. Chairman.

CROSS-EXAMINED BY MR HUME:

Q. In discussing the matter of abandonment of branch lines, Mr. Newman, with Mr. Evans, as I understood your answer you explained that in certain cases where your losses were very bad you felt that you should have the right to put on truck service to serve certain areas. I just wanted to ask you whether you thought that if that was so, and the particular province in which this branch was located refused to give you a license, whether you still thought that you should abandon your rail service and turn the business over by arrangement to a commercial trucker?

A. We will only have to face that condition when we are face to face with it. For example, here is a little cutting out of yesterday's paper:

"The Board of Transport Commissioners today authorized temporary discontinuance of passenger train service between Newcastle, Chatham and Loggieville in







New Brunswick, provided the Canadian National Railways replaces it with a bus and truck service. The discontinuance is effective between April 1st and October 31st of this year, after which the Board will review the matter again."

That is only, in my opinion, just a forerunner of the many cases like that that are going to occur in future years.

THE CHAIRMAN: Q. What were these points, by the way? Newcastle, did you say?

A. Between Newcastle, Chatham and Loggieville in New Brunswick.

MR HUME: Q. Mr. Newman, my question is, supposing in that particular case the province said that they would refuse to grant the railway a license to operate trucks, because say for example there was a commercial trucker there, would you still think, in your opinion, that you should abandon that unprofitable line and make an arrangement with a commercial trucker for serving that area?

A. That might be, but we cannot answer that question in generalities. It might be answered for any specific set of conditions when we know what those conditions are. We do not know what we are going to do; we have no set policy.

Q. No, I understand that.

A. And, furthermore, we have even considered putting flanges on truck wheels and running them on a branch line, just the way you would on a highway, and get away from all the restrictions that we might have. As long as we only operate one train at one time on a branch line we can get rid of an awful lot of rules. We do not know. If there is a trucker in that area that we felt would protect the railway's interests just like he would his own, and do it at as low a rate as we could do it ourselves, we would probably give the business to the trucker; but we do not intend to



supplant the trucker.

Q. Thank you, Mr. Newman.

THE CHAIRMAN: We will adjourn now.

---The Commission adjourned at 1:00 p.m., to meet again  
at 2:45 p.m.



Ottawa, Ontario  
Friday, March 10, 1950.

A F T E R N O O N   S E S S I O N

WILLIAM ARTHUR NEWMAN - Recalled

CROSS-EXAMINATION BY MR. MacPHERSON:-

Q. Mr. Newman, this program that you discussed this morning, this \$400 million program, is the same program that we discussed a year ago before the Board of Transport, I think?

A. Yes, it is based on the same study, Mr. MacPherson.

Q. Based on the same study, and it is based on an expanding national economy?

A. Only part of it.

Q. To what extent is it based on an expanding national economy?

A. In the figures that were given in the table this morning, it was separated out, the part that was the expanding national economy.

Q. Now, in the event of the national economy not expanding as you anticipate, then what would be done so far as the program is concerned?

A. The program is predicated upon our average needs for transportation,. As regards restoration of work capacity and improving our position to provide economical transportation, the only portion of it that is in any way, is the part depending upon expanding national requirements. In the first place the expanding national requirement is based on what we consider a conservative estimate of the increase in population. But, as you will recall in the rate case, Mr. MacPherson, and as I repeated again this morning, the expanding national requirement portion is





the only one that can be determined upon with any certainty, as it is examined each year in relation to what has happened in the past year.

Q. So that the expenditure of that amount which is set aside for the expanding national economy would be dependent on a continuance of the trends that you indicated a year ago?

A. That is correct.

Q. And the trend that we discussed a year ago did not, insofar as freight traffic was concerned, continue during 1949?

A. Now we are speaking about two different things. Ours is predicated upon the growth in population. The traffic is a varying amount that varies up and down according to industrial requirements and the amount of the national income and all the rest of it. This program that we have is a normal program based upon normal traffic requirements, not the actual year's requirements; and upon the actual increase in the population and its effect upon normal traffic requirements, not the actual requirements in the year 1949.

Q. Now, do the actual requirements in the year 1949 and the condition of traffic, do they affect in any way your program

A. No.

Q. Don't affect it at all?

A. No.

Q. You were talking of population. Have you considered 1949 as against 1948 in the matter of immigration?

A. Yes, you will find that in the rate inquiry, if I



remember correctly; that we had our trend charts on the growth of population. We scaled down our probable growth in population to be conservative, but the 1949 increase in population has of course exceeded what we anticipated, very much so.

Q. Now, in the matter of immigration, have you noticed whether or not immigration was down in 1949 as compared with 1948?

A. I must say, Mr. MacPherson, that I think even more important than immigration is the natural rate of increase or growth in our own population, plus the balance of immigration between the United States and Canada. That has been quite a potent factor in the past.

Q. Isn't it still, Mr. Newman?

A. Yes, but not to the same extent. I am quite pleased to find that a far greater percentage of our young men are finding good employment in Canada.

Q. What I wanted to clear up definitely with you was that traffic as such was not going to weigh so much with you as increase of population?

A. No, that is not so, because, as I tried to make clear, the position we are in now is on an entirely different economic plane to what we were before the war, and we must change our methods in order to provide cheap transportation. As far as expanding national requirements are concerned, that is only something that we measure each year; and if it decreased and if there was no increase in population, why, the coming year there would be no provision for increased amount of equipment to handle that traffic.

Q. Now, this sum you mentioned, this 400 million,



that is a gross sum, isn't it?

A. That is the gross capital required.

Q. That is the gross capital required, both for equipment and for road?

A. That is correct.

Q. And in road you expect to spend it largely for heavier rail?

A. Now, let us be careful on that.

Q. I wanted to find out to what extent it would affect structures.

A. In these coming five years the expenditure for rail is intended to be the exact weight of rail that we are now using on our main line. The only sense in which the weight of rail is heavier is that the rail that comes out of the main line goes into important branch lines, and so on down the line, and ultimately displaces a light weight rail; and it is the difference in the weight of the light weight rail displaced and the new main line rail that goes in that means heavier rail. It is no change in standard.

Q. The only charge to capital is the difference in the increase of weight?

A. That is correct.

Q. So that the road property which you estimate to improve, includes structures as well as rail itself?

A. Yes, the road property, I think, was enumerated by Mr. Crump in some detail, and it is also in the text in the Appendix; but it includes the most important things, as I said, which are things which take us over the line and includes automatic signalling, centralized traffic control, passing tracks, terminals and the necessary change to structures and buildings and fueling facilities that are





required for dieselization programs, plus also a moderate amount of curve straightening and the elimination of a few grades.

Q. Now, Mr. Newman, the Montreal terminal project is about finished?

A. It is not in that program.

Q. It is not in this program at all?

A. No.

Q. It is finished and that is paid for now?

A. That is paid for. It is not in the program.

Q. Not in this program at all, not part of the 400 million?

A. No.

Q. Now, you mentioned this morning the program that you had back in the 1920's. Back in the 1920's the Company was not on depreciation accounting, was it?

A. No.

Q. Today it is, is it not?

A. Yes.

Q. Now, according to your annual report at page 30, there was drawn down and charged to expenses in respect to depreciation the sum of \$9,600,000 in respect of roads and \$18,800,000 in respect of rolling stock?

A. What is that, on the 1940 annual report?

Q. 1948, 9.6 million and 18.8 million?

A. Yes.

Q. There would be no corresponding figures in the 1920's?

A. I should have to look at it pretty carefully, because actually in those days you charged to expenses the whole cost of the equipment that was retired, which



would be far greater than the depreciation.

Q. Well, what I am saying to you is, that today, in 1948, you have drawn down this sum of 28.5 million?

A. Yes.

Q. And that money is put in a reserve for the purpose of purchasing new equipment and paying off those and doing other things in connection with the Company. Now, there was no such depreciation accounting in the 1920's?

A. No, but you would have to examine the statements for the particular year, because there was something equivalent to it, Mr. MacPherson.

Q. I want to be fair in connection with that figure too. That was the figure, 28.5 million, that was on the user basis, and for rate-making purposes it would be reduced some \$7 million on straight line; but in any event under the last decisions of the Board of Transport there has been allowed to the railway the sum of \$15 million as surplus too, hasn't there?

A. Yes, to come and go on.

(Page 17725 follows)



Q. And this \$400 million programme, at \$80 million a year. you could look to depreciation reserve, as it is now being charged, and you could look to surplus as well?

A. Yes.

Q. And that would mean that instead of having to find \$400 million of new money, you would have to find a very much lesser amount?

A. Well, less but in a different way. On an \$80 million a year programme we would find some from those two sources.

Q. That is what I say.

A. This last year --

THE CHAIRMAN: Q. You would have to find what?

MR. MACPHERSON: Some from these two sources.

THE WITNESS: Take this year, it wasn't nearly enough by less than half.

MR. MACPHERSON: Q. In any event, what I want to make clear to the Commission is that the whole \$400 million. would not, under the company's financing now, be required as new money for the purpose of financing the programme.

A. No, and I don't think it was ever suggested that it was.

Q. I am just clearing it up. It wasn't suggested either way, but I am simply indicating that there was a gross figure given of \$400 million.

A. That is correct.

Q. And there would be a net figure that you would require to raise by way of new financing.

A. It is presented as the order of the programme that we feel we must have, merely as to the gross capital





expenditures. There has been nothing said as to how it would be financed; it is merely to show the order of gross requirements, that is all.

Q. To follow up the implication that there is \$400 million of new money required, that amount of new money would not be required.

A. That has never been suggested by me, Mr. MacPherson, and I don't think it has ever been suggested by anyone.

Q. To get the facts to the Commission then, in any event, the sum or \$400 million by way of new financing would not be necessary?

A. That, Mr. MacPherson, is a question you must ask the financial officers of our company, that is as to how the money is provided and so on. All I can do is indicate what I consider, from an engineering viewpoint, are our requirements.

Q. I asked Mr. Liddy some questions, and he said that he knew very little about this programme. That is why I am asking you.

A. I can tell you all about the details of the programme.

THE CHAIRMAN: There was some discussion this morning, on a question that comes up every once in a while, about the necessity of the company bringing its common stock to par and then financing. Suppose you canvass that a bit.

MR. MACPHERSON: Q. So far as financing, Mr. Newman, have you found that it is essential in your inquiries to bring the common stock, that is the ordinary stock of the company, back to par before you can do this financing?



A. My purpose as a research officer is to develop the problem. I have developed the problem as to what the needs of the company are; the finding of the money is the duty of the financial officers of the company. I think Mr. Unwin, in the rate case, told you that as far as he was concerned he had to find the money in various ways, and that in his opinion that all new money that was required, whatever the amount might be, that sixty per cent should be share capital and the balance might be long-term debt, that is of new money. Of course, this is not all our requirements.

MR. EVANS: I could help you, Mr. MacPherson, on that by giving you a reference . . .

MR. MACPHERSON: I know what Mr. Unwin said before. I am now simply trying to follow up what the Chairman said.

THE CHAIRMAN: Perhaps you might let me know later what Mr. Unwin said.

MR. EVANS: Yes.

MR. MACPHERSON: Q. You don't know anything about that angle of it?

A. The only thing I can say in regard to financing is that for 1950 we will spend \$33 million, and the balance is what we are not able to do because we are unable to carry it.

Q. In respect to the rolling stock that you purchased in 1949?

A. Yes.

Q. Was there any of that financed by way of equipment obligations?

A. No.

Q. None?

A. No.



Q. You had nothing to do with that in any event?

A. That isn't my job, but none was financed by equipment trusts.

Q. And you do not know whether any effort was made to finance in that way or not?

A. I know that for continuing programmes our company considers equipment trust is a very dangerous way of financing.

THE CHAIRMAN: Q. What is a very dangerous way?

A. The equipment trust method of buying equipment; the reason being that they are usually short term, ten years, and as soon as you commence to get repeat ones, the first thing you know you are paying not only the full amount but interest charges as well. It then becomes a much heavier burden on you than if you were able to carry it by other means. It is resorted to for peak buying when it is desirable, but not as a general standard practice.

MR. MACPHERSON: Q. As a matter of fact, over a period of years --?

COMMISSIONER INNIS: Q. What was the interest rate you generally paid on equipment trusts?

A. It varies a great deal, depending on the nature of the equipment and other considerations; I don't know except that it may vary anywhere from two per cent to three per cent.

Q. I was just wondering whether the interest at four per cent was high, if you were thinking of that?

A. These economic studies are made over a long period of time, away beyond the period of any equipment trust; therefore, with the lack of knowledge of the money market conditions, and after discussing it with our





financial officers it was considered wise, on a conservative basis, to take it at four per cent.

MR. EVANS: I wonder if I might help you on that point, Dr. Innis. In the 20 per cent case, Mr. Unwin at page 2437, described the limit beyond which you could not go in financing by those serial maturities. He said at that stage, we have nearly reached that limit. 'Perhaps that would be helpful.

COMMISSIONER INNIS: Those were on two or three per cent.

MR. EVANS: I have a reference to that in our annual report for 1948, at page 29, where there appears a list of all outstanding equipment; and the interest rates as shown there vary from a low of one a half per cent to a high of three per cent.

COMMISSIONER INNIS: Thank you.

MR. MACPHERSON:Q. Over the years, Mr. Newman, the Canadian Pacific has, according to its annual reports, carried equipment obligations most of the time?

A. That is right.

Q. Mr. Newman, you referred this morning to the cost of freight cars now. I think you said the average was \$7500.

A. For freight cars?

Q. Yes.

A. I said they were taken at \$7500 in our study of our requirements. Actually the average of a freight car in the year 1947 was \$9400.

Q. That freight car, which would replace another freight car, would be a very much better type of car?

A. Well, if you are getting at the working capacity that is taken into account in our study, we



merely replaced the weight carrying capacity of the car.

Q. But as a fact it is a very much better of car?

A. That all depends, Mr. MacPherson. It is a better type of car, and it always goes into a superior class of business.

Q. What is the capacity of the cars, on an average, the old cars?

A. There has been a variation in our capacity of cars in the last twenty years.

Q. The cars which you are building now, what is their freight capacity?

A. They vary all the way from forty tons to seventy-five tons.

Q. Do you build many forty-ton cars now?

A. Refrigerator cars carry only forty tons.

Q. Apart from refrigerator cars - general box cars?

A. Box cars, they are nearly always built with what we call five and a half by ten sized journals, and they have a nominal capacity of fifty tons.

Q. Fifty tons?

A. Yes.

Q. You spoke of passenger cars. Did you say you were paying \$200,000 for passenger cars?

A. I said certain kinds. Our new sleeping cars which are being built today are \$200,000.

Q. Are you building many of these?

A. There is a total of fourteen going through the shops at the present time.

Q. And these cars are very different from the old cars?

A. Yes, they are.

Q. I mean it was not a case of keeping up with the



Joneses, or anything like that, in the matter of sleeping cars?

A. No; it is just a matter of a higher standard of living, people demand something better, and we find that there is more demand for them.

Q. Is that for transcontinental traffic?

A. Mostly; we have a few cars of that kind in service now, and they are in the transcontinental service.

Q. And those cars cost \$200,000?

A. Yes.

Q. What was the cost of the average sleeping car, apart from the special ones?

A. We haven't built any for a long long time. The last ones we built, making allowances for the application of air conditioning to them, cost in the neighbourhood of \$70,000. That is the old cost, Mr. MacPherson, and to bring that up in line with the \$200,000 car you would have to double that. That would be \$140,000 to \$150,000, at today's prices, and I am inclined to think that is a little low.

Q. But the cars you are building at your shops, which you were telling us about, cost \$200,000?

A. That is correct.

THE CHAIRMAN: Q. Those are the kind that are in use now on your transcontinental line?

A. They are the kind we are building for transcontinental service.

Q. Are there any now in use?

A. There are a few between Toronto and Vancouver?

MR. MACPHERSON: Q. You mentioned this morning, as I took it down, that as a railway you have to consider





changed conditions because of competition, increased labour costs and increased material costs?

A. That is right.

Q. I think this morning you put competition first, did you?

A. I only happened to say it first.

Q. But those are the three factors?

A. The economic conditions are by all means the most important.

Q. Insofar as labour costs and material costs are concerned, you would use the weapon of technological advances to meet a higher cost there?

A. That is one of the reasons for all this work we want to do and are doing as fast as we can.

Q. That is, you would cut down your labour costs and cut down your cost of material ultimately?

A. That is always the way things go. The minute that labour costs get higher and material prices get higher, you can afford to spend the money for ways and means to cut down material and labour costs.

Q. I am agreeing with you on that.

A. That is the principle.

Q. When you come to the other angle, the other feature which you mentioned this morning, the matter of competition, in your capacity as head of the research department you told us of certain studies you had made. Did you make any studies, for instance, in connection with pick-up and delivery rates?

A. No, Mr. MacPherson.

Q. None on these at all.



A. No; that is a field we have not investigated.

Q. You have not investigated that field?

A. No.

Q. Do you know whether or not some of the railways in the United States are considering abandoning that field?

A. No, I do not know. All I can say is that I think Mr. Crump told us there was a committee he had appointed that was investigating it to some extent for our company, but it is not the research department.

Q. Not the research department?

A. No.

Q. And have you made any study --

THE CHAIRMAN: Pardon me. What possible field did you mention that might be abandoned?

MR. MACPHERSON: Pick-up and deliveries.

THE CHAIRMAN: Yes.

MR. MACPHERSON: The l.c.l.

Q. In any event, you have made no study of that?

A. No.

Q. In connection with agreed charges, have you made any study of those?

A. Yes.

Q. You have made a study of those in your research department?

A. Yes, for the traffic department.

Q. And you have these studies available?

A. No, I haven't them here.

Q. They are not here, but they are available.

I think probably they would be useful studies for the Commission, but I am not asking to see them at the moment. Have you given consideration in greater measure



Mr. Newman, as head of the research department, to carrying out what you suggested might be developing, that is, the question of trucks, buses and aeroplanes, taking part of a field that rail would not need to take?

A. Do you mean abandoning rail facilities?

Q. Yes; any part of the territory at all.

(Page 17732 follows)





A. No. What we have done in the Research Department has just been general studies, that is, considering what has transpired in the United States, with the growth of highway traffic and what has happened. We cannot compare our conditions with those of the United States, because the intensity of population and the network of highways is altogether different from what we have in Canada. But we have made some general studies of the cost of our branch lines, and we do know that some of the costs of moving freight on branch lines is staggering, and we can see that in general a good deal of our attention must be concentrated in the years to come on these unremunerative lines which we have to serve, to see how they can best be fitted into our general transportation picture. Now, there have been no specific ones made but more or less the general approach to it, Mr. MacPherson.

Q. That is true of passengers as well, isn't it?

A. Passengers, Mr. MacPherson, yes, but we are not so much concerned with passengers as we are with the freight.

Q. Because in the long run you expect freight to pay the bill?

A. Not necessarily, because the passenger always contributes to paying the bill, but most of these branch lines today exist, and a good many of them exist to take the kind of freight that the highways cannot take, or because of winter conditions preventing highways serving communities, and the railways are there to serve them, and as far as I am concerned it is largely our ability to continue to provide freight service to these communities. Of course, as you know, on a good many branch lines now they only attach a passenger car on to a freight train two or three times or once a week.

Q. That is in Saskatchewan. Mr. Newman, you know of a



company, the Lake Erie & Northern Railway?

A. Yes.

Q. Which runs from Galt to Port Dover, I think?

A. Yes.

Q. Now, that is practically owned by the Canadian Pacific; I think there are 15,000 shares, and the Canadian Pacific owns 14,037, according to Moody?

A. Yes.

Q. Are you abandoning, to your knowledge, passenger traffic on that road and substituting bus traffic for it?

A. I would not like to say so, Mr. MacPherson. It has been considered, but I doubt if any conclusion has been arrived at.

Q. And are they your own buses, or are you contracting with independent buses?

A. I do not think any arrangement has been made, Mr. MacPherson.

Q. But it is a matter of consideration at the present time?

A. A matter of consideration.

Q. Does the company have arrangements with many independent bus lines in that connection?

A. Now, Mr. MacPherson, I am only the research, and not the truck operating department, and I cannot tell you what we have, except in general I know that we have arrangements with truckers, but I cannot answer specific questions.

Q. I mean, looking at even your time-table, just some of the items, item number 57 -- there are four or five that I found last night -- time-table 47 and time-table 20 and some others, where you have arrangements with Greyhound and various other bus companies. Do you extend the same arrangement to trucks? Do you make the same arrangement with independent truck companies?



A. There are similar arrangements with truck companies, yes.

Q. I mean truck companies not wholly owned by the Canadian Pacific?

A. Yes, there are such arrangements.

Q. Do you know where?

A. No, I do not, Mr. MacPherson.

Q. And you do not know, I suppose, whether or not one can get a through rate rail and truck?

A. No; you are out of my field, Mr. MacPherson.

Q. There was an article -- I don't know whether you saw it or not -- in the publication "Newsweek" on the 13th of February, dealing with "Why the Iron Horse Is a Sick Horse", and it refers to the fact -- I will read part of it:

"Last year, the heavily Dieselized Southern Railway System made \$22,000,000. Southern President Ernest Norris estimates that the road would have lost \$7,000,000 that year without Diesels."

You would not think that that would be impossible?

A. Mr. MacPherson, I have seen articles like that and a great many more which are very interesting and quite true but rather misleading, because these American roads frequently have the habit of quoting operating savings and not net savings. Most of the figures that I have seen in the States, we have had to go and get behind them and get the real facts, and when we do we find that certainly the diesels are paying, and paying handsomely, but not nearly to the extent of some of the figures that are published by American railroads.

Q. Now we will see if some of these statements in the article are right:

"Of 4,700 new locomotives purchased since the war, 4,350 are Diesels."







A. I would think that is right.

THE CHAIRMAN: Would you give me the figures again, Mr. MacPherson?

MR MACPHERSON: "Of 4,700 new locomotives purchased since the war, 4,350 are Diesels."

Q. You would think that would be correct?

A. Yes. As a matter of fact, some of the steam locomotive builders in the States have gone out of business, out of the steam locomotive business; they do not make anything but diesels now.

COMMISSIONER INNIS: Are you describing the Southern Railway System now, or the whole?

MR MACPHERSON: The whole, Dr. Innis.

Q. Then this sentence would seem to be in accord with your view:

"The roads also could improve their financial position and clear the way for more rapid modernization by abandoning some of their unprofitable services."

A. That is easier said than done, Mr. MacPherson.

Q. Well, I mean that would be your objective?

A. It would be very nice to do that -- such as grain traffic.

Q. Well, now, you and I are going to get into trouble if we start talking about grain traffic. I think we had better not talk about it, because the grain traffic comes up in a special pocket by itself a little later on.

A. Let us forget it, then.

Q. If you want to come in, then we will have you.

A. We will get in a hotel room sometime, Mr. MacPherson, and have that out between us.

Q. You must not forget, Mr. Newman, nor must the C.P.R., that it was the grain traffic that made the company what it is.



A. That is true, but it was the conditions that existed when the grain traffic made the company that did it, not today's conditions.

Q. I am glad you admit that as true. Then there is this further part:

"These losses could be cut by curtailing service and forcing shippers to use truck lines and passengers to travel by bus for short distances off main rail lines."

A. There again, that little paper of yours refers to conditions in the States. I do not know what the snowfall is down there, and whether or not they can run in the winter as well as in the summer, but it is not as easy as that in our country, under our winter conditions, and I would say that in general there will be a tendency towards that, Mr. MacPherson, but the degree in a sparsely settled country like Canada as compared to the United States is a matter for conjecture.

Q. Well, don't trucks run most of the year now in Ontario and Quebec?

A. On certain main roads they do, but not in all areas, and when you commence to look into agreed charges and all, you will find why -- because the cost of winter traffic can be very, very high.

Q. Yet the cost of traffic on the agreed charge is very much lower than it is on the class distributing rate in the west?

A. Well, Mr. Jefferson probably gave you all the information you wanted on that.

Q. Yes, we got the information we needed from him on that. Now, you have indicated this morning that the programme has been delayed because of lack of funds; actually up until last year at least there was a shortage of equip-



ment on the road, was there not?

A. Still is a shortage of some kinds of equipment.

Q. Still a shortage of some kinds of equipment?

A. Yes.

Q. Such as?

A. Box cars and refrigerator cars and long machinery flats, also covered hopper cars.

Q. Box cars are still short?

A. Yes.

Q. And in the matter of agreed charges, in the study there, what we have heard from Mr. Jefferson, the reason for being able to give an agreed charge is that you have the equipment that otherwise would be unused?

A. Well, as far as that goes, the agreed charges cover certain specific commodities, and you have to commence to be specific until you consider it. For example, on refinery products---

Q. Mr. Evans says he does not remember Mr. Jefferson saying that. I do not say that he said that in so many words. What I am suggesting is that the argument in connection with the out-of-pocket expenses was, the train was running in any event, and they might as well take a car along and take the goods along. I am drawing an inference from that.

MR EVANS: Yes; it was nothing to do with agreed charges; it was just a question whether in given circumstances that would be a fact.

THE WITNESS: Agreed charges in general, Mr. MacPherson, are quite remunerative to the railway company.

THE CHAIRMAN: Q. Are what?

A. Quite remunerative.

Q. That is to say, you have about 43 agreed charge contracts in the country now?





A. Well, I don't know---

Q. And is it as a result of the working out of these contracts that you say they are quite remunerative?

A. Yes.

Q. It is experience, then, that is showing this?

A. Yes.

MR MACPHERSON: Q. And you are aware of the difference between the agreed charge rate on a commodity and the charge and the regular rate on the commodity?

A. Well, you have to answer that in generalities. I do not know all the things that Mr. Jefferson knows, which almost are multitudinous, but we do know, Mr. MacPherson, the studies that Mr. Jefferson asked us to make as to whether or not the level of certain agreed charges are remunerative or otherwise, and my answer is that so far on the studies that we have made for Mr. Jefferson the agreed charges were quite remunerative, and most of them -- and I think Mr. Jefferson himself made this statement -- equal to or above the average return per ton mile that the railway gets.

Q. Well, I am interested in the agreed charge particularly on petroleum products, in the light of the facts there as they appear in Mr. Jefferson's evidence. Now, I think, Mr. Newman, that this programme that you suggest provides for an additional maintenance expenditure of \$10 million a year, doesn't it?

A. I don't know where you get that figure from, Mr. MacPherson.

THE CHAIRMAN: What is the figure you say?

MR MACPHERSON: \$10 million.

Q. I think that is right, Mr. Newman?

A. Oh, I know what that is, Mr. MacPherson; that is the charge to maintenance for the rail and rail fastenings.



Q. That is an additional charge which would be charged to maintenance?

A. That is charged to maintenance by the system of accounting that is followed. The capital portion is only the difference in the weight of the rail.

Q. That is right; and that is where you get that amount of \$10 million?

A. That is correct.

Q. In respect of the rail and the fastenings in respect of the rail?

A. And ballast to a certain extent. It is railway track -- rail, other track material and ballast.

Q. In so far as the programme is concerned, the \$400 million programme, the amount of which I suggested was gross, there is the depreciation which you draw down in any event now on equipment and on road?

A. Yes.

Q. There is what is allowed for surplus?

A. Yes.

Q. \$15.2 million. Then there would be depreciation from year to year?

A. Yes.

Q. On the new items you buy here?

A. That is correct.

Q. And in addition to that there would be the progressive savings which ultimately would come to \$25 million a year after the fifth year?

A. No; that is the gross saving, and the net saving was only \$6 million a year.

Q. That is after taking into consideration interest---

A. All the charges.

Q. All the charges. But you would have progressive savings if you had proceeded with your programme for two



years and dieselized to a degree, not completely; then you would have provided a measure of savings for that two years?

A. That is true, if you take that in relation to my statement that savings do not come out fully hatched; they are progressive.

Q. That is right.

A. You start in and introduce them, and you do not get the full savings for probably two to three years after you start to introduce your diesels.

Q. Well, I am agreeing with you, only I am suggesting that the \$25 million, from which you must subtract costs of financing, does not start when your programme is completed?

A. No.

Q. But progressively as the programme proceeds you are saving money?

A. That is right.

Q. That is right. I do not think there is anything more, thank you.

(Page 17740 follows)





THE CHAIRMAN: Does anybody else wish to examine Mr. Newman?

COMMISSIONER ANGUS: Mr. Newman, is there any collaboration in research between the Canadian Pacific Railway and the Canadian National Railway?

A. Very much so. We keep together pretty closely. You may be interested to know that we are now bringing out common specifications for box cars, so we buy only one type of box car. We hope that we will reach the stage when we need only put C.P. or C.N. on it and that is the only difference there will be. We are collaborating together more closely all the time, and there is a very good spirit of co-operation between the two railways.

Q. Such competition as there is between them then does not come into this scheme?

A. No, competition can be for the sale of goods, but planning and equipment and all the rest are problems which are common and we like to pool our ideas and knowledge.

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PROFESSOR J. L. McDOUGALL - Called

EXAMINATION BY MR. EVANS:-

Q. Professor McDougall, you are Professor of Economics at Queen's University?

A. Of Commerce, yes.

Q. Of Commerce?

A. Yes.

Q. Would you tell the Commission something of your education?

A. Well, I was educated here in this city at the Ottawa Collegiate, at the University of Toronto where I took my B.A. in 1921, and M.A. in 1923 with a thesis on the Welland Canal Company.

Q. That was under Dr. Innis?

A. It was done under the direction of Dr. Innis

Q. 1923-1924 I was at the London School of Economics; 1924-25, Graduate School of Arts & Sciences, Harvard University; 1925-1926 Instructor in Economics, University of Texas, Austin, Texas; 1926-1927, Lecturer in Economics University of Toronto; 1927-31, Chief Statistician, Canadian General Securities, Toronto; and from 1932 to date, of the staff of the School of Commerce and Administration Queen's University. At present I have the rank of professor there.

Q. Then have you published any books or articles?

A. Yes.

Q. What are they?

A. "Railway Wage Rates, Employment and Pay", published by Longman's Green of Toronto, 1944; "The Foundations of National Well-Being", Ryerson Press, Toronto, 1944.



Q. And articles?

A. In the Canadian Journal of Economics and Political Science, the Canadian Banker, the Canadian Chartered Accountant, and Canadian Business.

Q. Now then, have you acted in a consulting capacity at any time?

A. Yes, I have been retained at various times by the International Railway Company of Buffalo, New York. That was in respect of a subsidiary in Canada, the Niagara Falls Gorge and River Railroad.

Q. Before you go on with that, is there any reason why you should not say what kind of work that involved?

A. Well, that particular assignment was to develop the original cost of a railroad property on which there was a detailed physical inventory as of August 31, 1932. I was asked to supply the costs as of the original period, and multiply them by the quantities to find out what the original investment was.

Q. Now, you were about to say some other capacities in which you had been consulted or some other matters?

A. Yes, I have been consulted by the National Tax Equality Association of Chicago, Illinois.

Q. What was the nature of that?

A. It was a report on the taxation of co-operatives for the House Committee of Ways and Means. I appeared in Washington on that in November, 1947.

Q. And anything else in the United States?

A. Well, I have been consulted by the National St. Lawrence Project Conference of Washington, D.C. That was in relation to St. Lawrence waterways.

Q. Now then, in Canada what consultations have you had?





A. I have been consulted by the Canadian Chamber of Commerce, the Canadian Electrical Association, by the Dominion Motor Coach Association, Dominion Steel and Coal Corporation, the Canadian Collieries (Dunsmuir) Ltd., the Northwest Line Elevators Association, the Winnipeg Grain Exchange, the Canadian Retail Federation, the Steel Company of Canada Ltd., and the Canadian Gypsum Company Ltd.

Q. Now, would you tell us anything of a general character that might be helpful in understanding the nature of the work you were doing?

A. Well, the study for the Canadian Electrical Association, was also on the St. Lawrence. That was done and published in 1941.

Q. Yes.

A. For the Dominion Motor Coach Association it was a study of the movement of traffic by bus, done in 1942-1943. For the Dominion Steel and Coal and Canadian Collieries, it was a study of the coal industry of Canada. For Northwest Line Elevators it was again a tax question. It was the impact of corporate income tax upon people who were in competition with those who were tax exempt. For the Winnipeg Grain Exchange it was in connection with a submission to, I think, a committee of the Canadian Government on freedom of international trade. The Canadian Retail Federation was a study of prices and price control. For the Steel Company of Canada it was a strict market study and it was not published but was merely for their own use. For Canadian Gypsum Company Ltd., it was a study of industry location.



Q. Now then, I understand also that you had some activity in connection with the Canadian Railway problem in previous years?

A. Well, I was invited by the Senate Committee to testify in 1939.

Q. That is in Canada?

A. Yes.

Q. And in the United States?

A. Well, the one I have already mentioned, the Committee of Ways and Means in 1947, on taxation.

Q. That is the one you have already spoken of. Now then, before I begin my examination, may I draw your attention, Professor McDougall, to pages 32-36 of Part I of the Canadian Pacific submission. In doing so, may I ask you this general question. What connection did you have with the submissions in the Canadian Pacific dealing with economic matters?

A. Well, I was there as a consulting economist while they were being prepared, and offered such advice as I thought proper in that production.

Q. Yes, generally speaking, what have you to say as to whether the views on economic questions set forth in the Brief coincide with yours?

A. They do, sir, yes.

(Page 17746 follows)



Q. At page 32 of Part I of the brief we are dealing with the subjects falling within paragraph 2(a) of the order-in-council appointing this Commission. Paragraphs 28, 29 and 30 of the outline submission indicate -- just skimming them -- that the disadvantages of certain sections of Canada in relation to transport services appear to be based largely upon the view that geographical disadvantages must be compensated for at the expense of those portions of Canada which possess geographical advantages, or at all events, at the expense of Canada as a whole.

And paragraph 29 says that the existence of economic activity in these sections is proof that they enjoy certain economic advantages over other areas. These advantages derive from cheap land, climate, fertility and so on.

Then paragraph 30 deals with the question as to the essential character of transportation to the economic realization of these advantages. Then the "further submissions" go on to deal with <sup>the</sup> more specific suggestions made. For example, at the top of page 32 --

THE CHAIRMAN: Page 32 or page 33?

MR. EVANS: Q. The top of page 33. After saying that transportation is only a single factor, and that other factors must be considered, such as climate, soil, mineral and forest resources and so on. . . the important fact, it is stated in the next paragraph, is not whether the area has some handicap in the economic sense, but whether balancing advantages against disadvantages, the community is able to participate fully in the economic life of the nation.





Then you refer to the northern mining areas having certain advantages, climate and transportation. You refer to the lack of agricultural opportunities in the Pre-Cambrian Shield; the advantages in mineral deposits there. Then you go on to suggest that it is pretty well impossible to compensate any part of Canada for the poverty of its soil and so on. Generally speaking, you are dealing with that question of advantages and disadvantages from the economic standpoint and from the standpoint of transportation.

Now then, Professor McDougall, you are, I understand, familiar with the argument which is set out on those pages on the subject of reducing transportation charges to compensate for geographic disadvantages. I would like to have your comment on that portion of the brief?

A. Yes, sir. As the submission points out, the country must be provided with transportation. That is essential to the full development of its resources, and should be accomplished with the least possible expenditure of labour --

MR. FRAWLEY: Mr. Chairman, I notice the witness is beginning to read from what appears to be a brief. I was wondering if he had a brief, and if it was available to us.

MR. EVANS: He is reading from notes he has prepared.

MR. FRAWLEY: I wondered whether he was reading --

THE CHAIRMAN: Does it make any difference whether he reads it or recites it from memory?

MR. FRAWLEY: No; it is just a question of whether this material would be made available to us.

THE CHAIRMAN: We will have it in the record.



MR. EVANS: Q. These are your notes, Professor McDougall?

A. Yes, sir.

Q. And you prepared them?

A. Yes, sir.

Q. Would you go ahead?

A. The setting of transportation charges to accomplish this result is a highly complicated process. Any reduction in transportation charges which does not result from a reduction in real cost is not of itself advantageous. In fact, it might produce even worse disadvantages to the nation as a whole than those which arise from geography.

Q. Perhaps you could give your answers just a little more slowly? Would you give, perhaps, a list of these disadvantages which can result from unwarranted reductions in transportation charges?

A. Well, I think, sir, if we are going to talk of reducing the disadvantages which flow from geography by reducing transportation costs, one might as well consider the extreme case in which transportation becomes a free good.

THE CHAIRMAN: Q. Transportation becomes what?

A. A free good, to be provided without a direct charge to the user.

MR. EVANS: Q. That is assuming transportation were free?

A. Yes. In one sense this would remove all geographic disadvantages but it would also produce results which are not expected by those who constantly press for the reduction in transportation charges. For example, consider the case of British Columbia.



British Columbia has great forest wealth on which it is creating a growing manufacturing industry. What began as a pure logging economy has gone to lumber and then to pulp, paper, plywood and other specialties. But if British Columbia logs were to be made available in Winnipeg, Montreal and Toronto, free of charges, then there would certainly be a tendency for the wood-using industries to concentrate in those older areas, rather than for them to develop in British Columbia. Timber loses a great deal of weight --

THE CHAIRMAN: Q. That amounts, does it not, to saying that if you had free transportation you could not conceivably have any differential between the manufactured products and raw materials?

A. Oh, quite. There are no differences at all in transportation costs, and therefore the other factors pull where they are presently by restricted but relative costs.

MR. EVANS: Q. Now would you give me just some examples in connection with timber?

A. Yes. As I say timber loses a great deal of weight in the manufacturing process. The existence of transport costs makes it desirable to process it as close as possible to the point of origin. Once that restraint is neutralized the other locational factors tend to pull the raw material towards the ultimate consuming market.

Q. Would you say something about the industries that have been created in Nova Scotia, and probably those which may come in Alberta as a result of coal deposits there.

A. Well, sir in the same fashion, the industries which have been created in Nova Scotia and those which





have been and will be set up in Alberta on the basis of the coal in Nova Scotia and the coal and oil deposits in Alberta, might be more profitably developed in Ontario and Quebec.

Q. Then would you say something in connection with the argument of the Province of Alberta about the packing-house industry and the processing of livestock in Alberta?

A. Well, if I understood that argument correctly, it was that there is already a tendency for the packing-house industry processing Alberta livestock, to be established outside Alberta. If this tendency now exists, it would then strengthen if freight charges were abolished.

THE CHAIRMAN Q. It would be strengthened if what happened?

A. If freight charges were abolished.

Q. Did you say "abolished"?

A. Abolished.

MR. FRAWLEY: Perhaps I do not understand this evidence at all because nowhere in the record have I asked that freight charges be abolished.

MR. MACPHERSON: Mr. Chairman --

THE CHAIRMAN: Mr. MacPherson disassociates himself likewise.

MR. EVANS: If my friend had listened to what the witness said he would have heard, and it is in the brief. He was taking the extreme case to illustrate what happens when you try to reduce transport costs to make up for geographic disadvantages.

THE CHAIRMAN: And he began by showing what might happen when you abolish costs altogether.



MR. EVANS: I suppose that if you continue to have costs reduced by reason of geographical disadvantages you can consider that ultimately you might have to carry everything for nothing.

COMMISSIONER ANGUS: Q. Are you going to consider later, Professor McDougall, the possibility of reducing selected freight rates to zero. . . not all freight rates to zero, but some?

A. No, sir; I had not prepared myself so, but it is an interesting idea. Take British Columbia as an example, if you were to reduce the freight rates on logs to zero, leaving lumber high, of course it would play even more strongly to pull towards the established centres.

MR. EVANS: Q. Then you mentioned earlier that transport is an economic good. Would you care to describe what you mean by that?

A. Well, I mean by that that it is something which it takes effort to produce, and which people want to have. Like all other goods, it has been rationed in order to keep some sort of balance between what people are willing to consume and what can be produced. Transportation charges, like all other prices, are simply a method of rationing. The willingness of the public to pay prices is the method by which they ration their use of goods and services in a free economy. If there were no attempt made to ration the amount of transportation demanded, then there would be a tendency to divert to the provision of transportation, labour and materials which could be more fruitfully used elsewhere.

Q. Just to get your view there. You say that the fact that people have to pay for transport



has a rationing effect on the use of transport?

A. Yes, sir.

Q. Did I understand you to say that the nearer you get to zero the more likely you are to put more than the proper effort into the production of transportation services?

A. Yes; that each time public investment attempts to supply the capital required to meet the demand at the established price level, it would pull people into creating transport means, who could produce more valuable goods if they were to go elsewhere.

THE CHAIRMAN: Q. You began by talking of regions which are suffering from economic, geographic disadvantages and so on; and you point out how fruitless it would be to give them free transportation. That is what you are talking about?

A. Yes.

Q. So far as I know, we have not heard from any people of that kind who are asking for free transportation.

A. No sir; but I think --

Q. Do they not also admit this, that in view of the distance they expect to pay more in freight rates than people who are nearer to the same destination? Do they not admit that?

A. Yes.

Q. Is it not then just a matter of what in their view is a proper apportionment of what they should pay - the long and short haul?

A. I think it is rather more than that sir. As I understand it, some of them who already have had reductions in their transport charges are interested in getting still further reductions; and some who have not





had --

Q. But it is still on a basis of just proportion, as they say. . . they may say it mistakenly. Is that not right?

A. No, I don't think so.

Q. You think they want more than that?

A. I think they are inclined to push justice until it squeals.

MR. EVANS: Q. Have you in mind anything about the Maritime Provinces in their submission?

A. Yes. I was considering explicitly the evidence of Professor Love . . .

THE CHAIRMAN: I should perhaps not be interrupting at this point, but it does seem to me that the Maritime Provinces are dealing with a certain agreement or pact made at the time of confederation, and brought forth and recognized by parliament.

MR. EVANS: I am not going behind that. I am not going behind anything they now have. But the submissions made here were that these advantages should be extended.

THE CHAIRMAN: Well, that statute was passed, and it recites in its preamble the reason for its being passed; they say conditions have changed so much that that statute no longer carries out the agreement as it was conceived, going back to before confederation.

MR. EVANS: I had not understood them to limit the question to that extent, but I am sure they will argue whatever they see fit to argue.

MR. BARRY: That is just what the section says, what the Chairman quoted.



MR. EVANS: What section?

MR. BARRY: In the maritime submission.

THE CHAIRMAN: What I have in mind is that we are dealing with a question of fair proportion. I am not saying that some who give a definition of fair proportion are not exaggerating their own rights in the matter, but nobody is asking for free transportation.

MR. EVANS: They are coming fairly close to it.

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THE CHAIRMAN: Are they?

MR BARRY: Professor McDougall is taking us close to it.

MR FRAWLEY: That just shows what we have to contend with, if that is the idea my friend has after, ninety-one days.

MR EVANS: After ninety-one days, Mr. Frawley, I think you can say I have been reasonably fair to you, and I just want to say this---

MR FRAWLEY: That last remark just washes it all out.

MR EVANS: I want to be corrected, Mr. Frawley, if I am wrong, and if I am wrong I expect you to correct me, but it seems to me quite clear that there is no group here represented that does not want cheaper freight rates.

THE CHAIRMAN: Yes.

MR EVANS: And I think it is fair to say that they want it either at the expense of the railways or through subsidies in some form.

MR FRAWLEY: I take exception to what you say, because that is not my position.

MR EVANS: Well, I said some of them, in some form. My friend Mr. MacPherson, representing Saskatchewan, wants a very substantial subsidy. Now, we have not said anywhere that anybody wants free transportation, but we say that you do point to the fallacy of relatively freer transportation, if you like, by pointing to the extreme case, and we make it an extreme case. We do not say anybody wants free transportation. Now, are we all satisfied that we can go on?

THE CHAIRMAN: We have settled that. Nobody wants free transportation.

MR FRAWLEY: No Members of Parliament here.





MR EVANS: And we do not suggest it.

THE CHAIRMAN: You are not offering it.

MR EVANS: Q. What have you to say, Mr. McDougall, about the relationship between transportation and other work done in a community?

A. Well, I say sir, that transportation may be a strategic factor in the total productive effort of the community, but it is similar in principle to all other work done in the community. The effort spent on transportation is simply part of the cost of production. If it is desirable to use prices as a method of distributing the goods and services produced among those who have contributed to their production, then it is equally desirable to make charges for the service of transportation.

Q. Has that any particular relation to rail transportation, in your thinking?

A. Yes, sir; I think it is very specially important in relation to rail transportation. Rail transportation is still the most important form of transportation in Canada. Rail transportation has an unusually high ratio of capital investment to annual sales. Therefore any sharp increase in the demand for this service must involve a very costly increase in the capital invested in transportation. The only way in which to avoid this investment being excessive and wasteful is by the use of prices which will turn the labour and materials to other uses where they will make a greater contribution to the wealth of the nation.

Q. Now, I think we all recognize, Mr. McDougall, that those who complain about their geographic disadvantages are not actually asking for free transportation. I presume that what you have been saying is that every move in that direction, whether by subsidy or by forcing the railways to carry goods at uneconomic rates, is a tendency toward that wasteful con-



dition of which the perfect example is free transportation?

A. Precisely, sir. I do not know of anyone who is asking for free transportation, but many ask for cheaper transportation, including some who have already had a prior reduction in their transport rates.

THE CHAIRMAN: Q. I thought I understood you, when you were illustrating the effects of free transportation, and therefore, as Mr. Evans says, of unduly low transportation, as pointing out how disastrous it would be to the producer himself -- the producer of lumber, for instance; his lumber would get to Montreal for nothing, and---

A. But you must decide where your producer starts. The man who produces logs in the woods---

Q. You started him in British Columbia, you see?

A. Yes.

Q. I was just carrying on.

A. But I took the logger only because the logger is an individual -- the logger is going to be greatly helped if you carry his logs free to Toronto, but the man who makes lumber in Vancouver or any other mill town, he is not.

Q. I meant the producer of lumber in Vancouver.

A. Oh, yes.

Q. He is the one I had in mind. If his raw material can get to Montreal free he will suffer from it, you see?

A. Oh, quite.

Q. Well, that is the kind of man. How do you associate him with the producer of other products -- wheat, for instance?

A. I do not think I have got your point yet, sir.

Q. Well, the producer of wheat, for instance, how does he suffer if you make the transportation of his commodity too low?

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A. Well, of course, if you are going to make it general, then you are in effect transferring what is now paid by a direct charge into an addition to the tax collection.

Q. The tax collection?

A. Yes.

Q. Oh, well, that is a different thing.

A. And of course if you are going to provide more and more and more transportation, you must not only collect for current operation, you must collect for your capital investment also.

Q. Well, that is a totally different branch of the subject. I thought you were showing how the home producer would suffer if the raw material which he uses at home could be transferred free elsewhere; isn't that what you started to illustrate?

A. I was illustrating rather the disorganization to particular areas which are now asking for shall we say consideration, for lower rates for this, for that and for something else.

THE CHAIRMAN: Well, go on, Mr. Evans.

COMMISSIONER ANGUS: Q. Aren't you really saying that because people ask for cheaper transportation they ought to be even more pleased if they got transportation for zero? A great deal of the evidence that we have heard here has not had to do with the absolute level of rates, but with their relative levels, and people have asked that the difference between one place and another should not be too great -- not necessarily that it should be zero.

A. But if you make all rates zero you also wipe out your relative problem.

Q. Well, you are wiping it out, unless what is wanted is to have a differential.





THE CHAIRMAN: Q. Are you not putting the problem on a false base when you reduce it to zero? You lose all relativity then; you wipe out all pursuit of the question---

A. I am not suggesting it, sir; I am merely trying to carry an argument to its logical conclusion.

COMMISSIONER ANGUS: Q. Well, have you carried it through? Would not the extreme conclusion be subsidized freight rates, and perhaps subsidized unequally? I mean, you have carried it to the point where it is most difficult to discuss it, not because it is the extreme -- it is not the extreme; you could go on and subsidize movement, have negative freight rates.

A. Well, if you have a negative freight rate -- that is, you are really trying to re-establish differentials, but as it were reverse them; is that it?

Q. Yes; I mean, if you want the logical conclusion it is subsidizing movement, and it need not be an equal subsidy for every article?

A. No.

Q. By substituting zero halfway in your logical progress you have created the point of maximum difficulty.

A. Well, I thought of myself as going at least as far as the taxpayer would permit, if not rather too far. I shrank away from that final extension.

MR EVANS: Q. What would you say, if you began unequal subsidization, as to whether or not there might be a tendency toward others who were not equally subsidized asking to have a similar level of subsidy?

A. Well, of course, once subsidy begins the people who do not get it are automatic candidates for the next round. They have a very special interest to ask for the next round. They may even be compelled to accelerate the time when the next round comes about for decision.



Q. What is the alternative to this?

A. Well, I think the alternative is, sir, to adopt an economic approach, and make those who use transportation pay for what they get.

Q. Now, would you like to expand that a little bit?

A. Well, I think, sir, that the only way to reduce transportation charges is by a reduction in real transportation costs -- real, that is, in the sense of their use of physical factors for their production. I think that any other plan is not only wrong in principle, but would be self-defeating in practice.

Q. And what do you say the demand for subsidies is based upon? What do you suggest about it?

A. Well, I think it is based on the illogical idea that in some way those who are to be helped by this change would find the aid given them a net addition to the advantages they now possess. I submit that even if they got their way this would not follow. It would not be possible to limit these benefits to a few situations. There would be a wasteful increase in all transportation activity which would damage the whole economy. The apparent beneficiaries of the subsidy would have to bear a share of the costs in taxes or otherwise; and many of their existing advantages would be lost in the shuffle.

Q. Now would you give us some concrete examples of what you have been talking about?

A. Yes, sir, I think I can. Halifax, Montreal and Vancouver have certain specific advantages which arise from being seaports. Edmonton, Calgary, Saskatoon, Regina, Winnipeg, Sudbury, Noranda, Kitchener, Brantford, Sherbrooke and other inland communities have advantages which accrue to each one from its particular location. Each has also certain transportation disadvantages arising from the



fact that it is inland and not upon a good ocean port and harbour. But if we try to give Calgary and Edmonton, for example, all the advantages of an ocean location, how can we avoid trying to give Vancouver all the advantages of direct and easy access to a great area of agricultural production? In attempting to remove transportation disadvantages we shall end by trying to remove transportation advantages.

Q. Now, what do you say as to whether those proposals are sound?

A. I do not think they are sound, sir. The great geographical forces are given and basic factors. Each successive generation must come to terms with them in the light of the techniques of the time and of the capital available to apply them. It is unrealistic to try to behave as if the Prairie provinces were not in the heart of the Continent or as if the Rocky Mountains or the Great Lakes did not exist. Any attempted denial of these facts in order to give everyone bread with jam on both sides is quite likely to end with everyone without jam and in danger of short rations of bread.

COMMISSIONER ANGUS: Q. Are you really arguing that every bridge should be a toll bridge, and every road a toll road? Does the bridge deny the existence of the river?

A. Your bridge is an expense.

Q. Yes, of course.

A. I am merely saying that in so far as it is an expense you recognize it.

Q. That means it should be a toll bridge?

A. Not necessarily. If it is part of a through line of railway---

Q. No, no; but I mean there is no question of





railway.

A. You are thinking of highway movement; is that it?

Q. Yes.

A. Certainly I would say that if you have a large and expensive bridge it ought to be a toll bridge, yes. If it is merely something short, you throw it in with the highway, but if it is a great bridge over a great river---

THE CHAIRMAN: Well, we will cross that bridge on Monday morning.

---The Commission adjourned at 4:10 p.m., to meet again at 10:30 a.m. on Monday, March 13, 1950.













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